

Winter 1-1-2009

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Recommended Citation

T. Keith Fogg, *Leaving Money on the Table and Providing an Incentive Not to Pay - The Story of a Flawed Collection Device*, 5 Hastings Bus. L.J. 1 (2009).

Available at: https://repository.uchastings.edu/hastings_business_law_journal/vol5/iss1/1

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LEAVING MONEY ON THE TABLE AND PROVIDING AN INCENTIVE NOT TO PAY—THE STORY OF A FLAWED COLLECTION DEVICE

*T. Keith Fogg**

I. INTRODUCTION

As of September 30, 2007, the IRS had \$282-billion of unpaid assessments on its books.¹ Of that amount \$58-billion, over 20 percent, represents the unpaid payroll taxes due from employers.² The majority of payroll taxes due from employers results from income and social security taxes collected by the employer and held in trust for the government.³ Internal Revenue Code section 6672 (“6672”) gives the government the right to pierce the corporate veil to pursue collection of these payroll taxes.⁴

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1. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-617, TAX COMPLIANCE: BUSINESSES OWE BILLIONS IN FEDERAL PAYROLL TAXES, 7 (2008).

2. *Id.* at 15; see also *Written Testimony of IRS Deputy Commissioner Services and Enforcement Linda Stiff Before the Senate Homeland Security and Government Affairs Permanent Subcommittee on Investigations on the Collection of Federal Employment Taxes*, 8 (2008).

3. The description of the importance of this system which the Solicitor General offered to the Supreme Court in the brief at pages 9-10 in *United States v. Sotelo*, 436 U.S. 268 (1978), still provides a good explanation of its importance:

Since 1942, the collection of income taxes by withholding at the source has been an integral part of the internal revenue laws. As a practical matter, Congress recognized that many persons found it difficult to pay their tax liabilities at the time they filed their returns after the close of the taxable year. By requiring withholding of taxes at the source, Congress sought to prevent the loss of large amounts of revenue that would not be collected between the receipt of income and the filing of the returns reporting such income.

Brief of Petitioner-Appellant at 9-10, *United States v. Sotelo*, 436 U.S. 268 (1978) (No. 76-1800).

4. “Any person required to collect, truthfully account for, and pay over any tax imposed by this

Because it creates personal liability, 6672 can serve as a powerful tool in the fight against the growing tax gap.

Unfortunately, 6672 is flawed in the way it operates due to its position in the Code as an assessable penalty. The interest charged under 6672 only runs from the date of the actual assessment against the individual and does not relate back to the due date of the corporate employment tax return. The flaw allows those responsible for failing to pay over payroll, and other,⁵ taxes collected for the government to avoid paying interest for two years or more.⁶ Additionally, the flaw provides an incentive for those responsible to withhold payment and delay assessment.⁷ Those studying the causes of the IRS tax collection gap uniformly identify the creation of incentives to pay and removal of delayed collection attempts as keys to successful collection and reduction of the gap.⁸

title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over." I.R.C. § 6672.

5. See Note, *The Private Tax Collector – A New Fiduciary*, 60 HARV. L. REV. 786 (1946). Several other types of taxes are withheld from employees or collected by third parties for the government. Railroad retirement taxes are withheld by the employer. The other types of taxes are excise taxes imposed based on purchases of goods and services. Two of the best known of the collected excise taxes are the communications excise tax found in I.R.C. § 4251 that appears on phone bills of consumers every month and the airline ticket excise taxes found in I.R.C. § 4261. Other collected excise taxes include the petroleum excise tax in I.R.C. § 4611 and alcohol excise tax in I.R.C. § 5001. In each of these excise taxes the consumer pays the tax at the time of purchase and the vendor collects the tax with the requirement to hold the money and pay it over to the government.

6. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-617, TAX COMPLIANCE: BUSINESSES OWE BILLIONS IN FEDERAL PAYROLL TAXES, 32 (2008). The National Taxpayer Advocate 2006 Annual Report to Congress highlights the need for early intervention in employment tax cases. It points out that only 18.9 percent of the 6672 liabilities in fiscal year 2006 were reported as dispositions with full payment. 2006 NAT'L TAXPAYER ADVOCATE ANN. REP. vol. 1, at 69.

7. The debate concerning 6672 exemplified by the recent GAO report and the Congressional and Administrative responses continue to miss the mark on how to use 6672 to improve collection. The focus of the report and the responses centers on improved IRS collection techniques. No doubt room for improvement exists but this issue has existed for 50 years or more without focusing on how tax laws could change to foster the increased compliance desired. This article is the first of two concerning 6672. The second will focus on structural changes to the relationship between the government and the third parties it uses to collect taxes for it, drawing from effective tax administration principles. Changes are needed in the information the government provides to insure these third parties understand the nature of the trust relationship created and the consequence of breaching the trust. Changes are also needed in the information provided to the government concerning who manages the trust. Instead of searching for two years or more to "find" the responsible persons, the government should require businesses to notify it of the individuals responsible. Changes are needed to modernize 6672 as a penalty in addition to a collection device by drawing from more modern excise tax provisions. Finally, changes are needed in situations where more than one person is responsible for failure to pay over the trust funds to incorporate incentives for early payment rather than disincentives.

8. Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695 (2002). See also Dennis J. Ventry, Jr., *Cooperative Tax Regulation* (American University Washington College of Law Legal Studies Research Paper Series, Paper No. 2008-47), available at <http://ssrn.com/abstract=1101826>; Sagit Leviner, *An Overview: A New Era of Tax*

Using the model provided by the tax gap literature, this paper identifies the source of the problem with 6672 and recommends a solution. The solution is to remove 6672 from the assessable penalty provisions and make clear in the statute that interest charges against the individuals responsible accrue from the due date of the corporate return. To set the scene, the article explains the operation of 6672. Following that explanation, it explores the purpose of 6672 focusing on its legislative history, Congressional policy, IRS policy, and decisional law. Finally, the specific problem of the treatment of interest under 6672 is addressed by examining the mechanics of the interest provisions, the misalignment with similar statutes and the problems created for the IRS by the current statute.

II. OPERATION OF 6672

Sections 3102(a) and 3402(a) of the Internal Revenue Code (the “Code”) obligates every employer to withhold (or collect) from its employees’ wages income and social security taxes.⁹ The statutes require the employers to pay over to the Treasury these collected taxes and section 7501(a) provides that these collected taxes constitute a special trust fund for the benefit of the United States.¹⁰ The term “person” used in 7501(a) means the employer and “person” for this purpose is defined by 7701(a)(1) to mean an individual, a trust, estate, partnership, association, company or corporation.

Section 7501(b) provides that persons violating the trust established in 7501(a) bring into play the penalties imposed in 6672 and 7202. Section 7202 provides criminal sanctions for failure to pay over collected taxes in certain circumstances.¹¹ I.R.C. 6672 lays out what the code describes as a

Enforcement – From ‘Big Stick’ to Responsive Regulation (Regulation and Governance Accepted Paper Series, 2008), available at <http://ssrn.com/abstract=1082247>.

9. “The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.” I.R.C. § 3102(a). “Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax.” I.R.C. § 3402(a).

10. “Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States.” I.R.C. § 7501(a).

11. This paper does not address criminal sanctions available to the IRS for failure to pay these taxes. These criminal provisions receive so little use that a citizen of the United States stands a much greater likelihood of being struck by lightning than being prosecuted under one of these provisions. About 400 people each year are struck by lightning in the United States. <http://www.lightningsafety.noaa.gov/medical.htm>. Almost no one is prosecuted for the crime described by this section. See *Wilson v. United States*, 250 F.2d 312, 314 (9th Cir. 1957) (finding that there “does not appear to be a single [prior] reported decision involving a felony prosecution for failure to pay withholding taxes.”); *United States v. Poll*, 521 F.2d 329, 334 n.3 (9th Cir. 1975), *cert. denied*, 429 U.S. 977 (1976) (after citing two other cases of felony prosecution for withholding tax violations, the court

civil penalty but which acts as a collection device.¹²

Section 6672 is sometimes called the Trust Fund Recovery Penalty (TFRP) and in other instances the responsible officer penalty or 100 percent penalty. The TFRP label derives from the fact that the taxes collected by the company constitute a trust for the United States and that 6672 seeks to provide an alternate means of recovering the trust fund when the company does not pay over the monies held in that trust. This article will use the term “collected tax” rather than trust fund to describe the taxes collected by the company and not paid over to the United States. While the article will focus its discussion on income taxes withheld by employers, the types of taxes in which the government uses third parties to collect spans a broad range,¹³ making “collected tax” a more appropriate term than simply “withheld taxes” or “trust fund taxes.” Also, the term trust fund tax implies that a trust exists when, in fact, it often does not because the trust res does not exist or has not been identified.

The responsible officer penalty label comes from the person to whom the penalty applies. This article will use the term “responsible officer” to describe the persons who meet the tests in section 6672 for piercing the corporate veil and imposing derivative, personal liability. The term responsible officer penalty will not be used to describe 6672 except as its use comes from specific case language. Similarly, the term “100 percent penalty” derives from the imposition of a liability upon responsible officers equal to 100 percent of the unpaid collected tax. Except for occasions when use of that term comes from specific case language, this article will not refer to 6672 with the term 100 percent penalty.

Collection of taxes through withholding operates as an efficient and effective means of collecting taxes; however, when the business collecting the taxes has cash flow problems, the collected taxes which the business should hold in trust for the government become a potential source of salvation that proves too tempting for some to resist.¹⁴ Typically, the

stated that “[t]o our knowledge these are the sum of the reported prosecutions under 7202 as applied to withholding taxes.”).

12. 6672 serves as a collection device because of the policy adopted by the IRS regarding this liability. That policy, set out originally in P-5-60, is discussed below in section III.C. However, taxpayers must be careful to properly account for withholding to ensure the withholding credit they receive matches the amount of tax owed. See MauledAgain, http://mauledagain.blogspot.com/2008_04_01_archive.html (Apr. 4, 2008, 8:39 EST).

13. *The Private Tax Collector*, *supra* note 5, at 786.

14. Numerous articles have been written on the trust fund recovery penalty of 6672. It is also the single most litigated federal tax issue litigated in the refund context. For a general overview of the statute see John W. Schmehl & Richard L. Fox, Responsible Person and Lender Liability for Trust Fund Taxes - §§ 6672 and 3505, 639-2d Tax Mgt. (BNA) A-45 (2000); see also P. Prestin Weidner, Note, *The Misappropriation of Trust Fund Taxes Under the Guise of Reasonable Cause*, 57 VAND. L. REV. 287 (2004); Gerald P. Moran, *Willfulness: The Inner Sanctum or Unnecessary Element of Section 6672*, 11 U. TOL. L. REV. 709, 721-22 n.36 (1980).

business owner faced with an inability to meet ongoing expenses and a bank unwilling to extend further credit seeks a “short” term solution by not paying over to the government the funds it holds or should be holding in trust.¹⁵ Unlike other creditors who know the taxpayer’s business and who are generally quick to react to nonpayment, the government responds slowly to nonpayment. This slowness may encourage the business to continue the practice of nonpayment of the trust fund taxes in the mistaken belief that either the business will soon turn around or the government does not care about the nonpayment. When the government finally arrives to recover the taxes due to it, the unpaid tax bill for collected taxes has reached levels the business cannot repay. The business ceases to exist leaving a large unpaid bill to the government for the taxes it “held” in trust.

It may help in the overall understanding of what happens in these cases to look at the situation briefly from the government’s perspective. The IRS does not know how much income tax each company withholds during a specific quarter until the company files its quarterly employment tax return. With the possible exception of some very large corporations or corporations with past delinquencies, no one at the IRS monitors the daily, weekly, monthly or quarterly practices of a particular company with regard to the payment of the income taxes collected from its employees. If a company files a tax return and on that return it lists a liability for which it does not remit payment, the IRS will assess the liability reported on the return and initiate the collection process. If a company fails to file a return, the IRS will usually notice that failure within a few months and initiate the collection process. Even the initiation of the collection process does not mean that an actual person will make contact with the company for weeks or months after the collection process begins because correspondence will usually occur first followed afterward by the assignment of a human.¹⁶ This explanation of the typical process merely shows how a company that

15. As mentioned previously this article does not seek to address whether a particular individual fits the responsible officer definition. This article presumes that a responsible officer exists and moves forward from that point. Although the discussion in this section provides background information about a “typical” situation, numerous reasons for not paying the trust fund taxes exists. Nothing in this article seeks to portray the individuals held responsible as miscreants or evil doers. Some individuals who do not pay the trust fund taxes do so with bad motives knowing that their actions seek to deprive the government of the trust fund taxes their business has collected. Many times, however, the person who ends up responsible has a good faith belief that the taxes will eventually be paid and just misjudges the economics of the situation. Numerous articles exist discussing whether someone meets the statutory criteria for assessment. See Doreen McCall, *Who is a “Responsible Person” – The Overreaching Power of the Internal Revenue Service to Collect Employer Withholding Taxes*, 18 OHIO N.U. L. REV. 905 (1992); Mary A. Bedikian, *The Pernicious Reach of 26 U.S.C. Section 6672*, 13 VA. TAX REV. 225 (1993) (starting at a different point and concerning only how the liability should attach once the determination of liability has occurred).

16. See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-728, *TAX DEBT COLLECTION: IRS HAS A COMPLEX PROCESS TO ATTEMPT TO COLLECT BILLIONS OF DOLLARS IN UNPAID TAX DEBTS*, 8-13 (2008) (discussing the collection process).

has collected taxes for payment over to the IRS could fail to pay the collected taxes over to the IRS for a reasonable period of time before the IRS will enter the scene and demand its money. It is easy to contrast the IRS action with trade creditors and commercial creditors who usually notice nonpayment much sooner. Consequently, a company experiencing cash flow problems may naturally tend to keep current with trade and commercial creditors and delay on payment of the collected taxes.

At this point I.R.C. section 6672 comes into play. Section 6672 allows the IRS to impose a liability, labeled a penalty, equal to the unpaid collected taxes on those persons who were (a) responsible for the payment of the collected taxes to the government and (b) willful in their failure to pay the trust fund taxes over to the government. The IRS may assess more than one person if more than one person meets the statutory tests.¹⁷ The IRS policy takes the view that the unpaid trust fund taxes should be collected only once.¹⁸ Even though it is possible for several people to be assessed the 6672 liability, the IRS will usually first attempt to collect from the entity that incurred the liability.¹⁹ In circumstances in which the IRS cannot collect from that entity, it will turn its enforcement mechanisms toward the responsible officers usually collecting from the responsible officer who presents that easiest case for collection.²⁰ If the IRS collects full payment from the entity or from one of the responsible officers, then it will stop and not seek collection further.²¹ If the IRS collects from more than one responsible officer and collects more than the total liability for collected taxes, then it will refund the excess to the person(s) from whom it collected after it received full payment.²²

17. *Brown v. United States*, 591 F.2d 1136 (5th Cir. 1979); *Turner v. United States*, 423 F.2d 448, 449 (9th Cir. 1970); *Bowlen v. United States*, 956 F.2d 723, 728 (7th Cir. 1992).

18. P-5-14 states: "The withheld employment and income taxes or collected excise taxes will be collected only once, whether from the business, or from one or more of its responsible persons." I.R.S. Internal Revenue Manual 1.2.14.1.3 (June 9, 2003). In 2003, the IRS renumbered P-5-60 to P-5-14.

19. I.R.S. Internal Revenue Manual 5.7.4.4 (Apr. 13, 2006), 5.7.3.1 (Oct. 30, 2007).

20. H.R. Rep. 104-506, at 1163 (1996), *reprinted in* 1996 U.S.C.A.N. 1143, 1163.

21. I.R.S. Internal Revenue Manual 5.7.7.7.2 (Apr. 13, 2006).

22. I.R.S. Internal Revenue Manual 5.17.7.1.9 (Nov. 2, 2007), 5.7.7.3 (Apr. 13, 2006); IRS Service Center Advisory 200026024, 2000 WL 33116108 (April 20, 2000). This policy also promotes the same tactics of running, hiding and delaying, attributed here to the failure to charge interest, when more than one responsible officer exists. A detailed discussion of the effect of this policy on compliance exceeds the scope of this article but an example demonstrates why this policy promotes delay. Assume ABC Corporation withholds \$100,000 in income taxes which it fails to pay over to the government. ABC goes out of business without paying this debt. Bob, Mary and John are the responsible officers of ABC and on July 1 each are assessed a \$100,000 liability based on 6672. Bob fully pays the liability on July 5. Mary fully pays the liability on July 6. John fully pays the liability on July 7. The IRS will keep Bob's money and refund to Mary and John all of the money that they paid. Since this occurred after the passage of 6672(d) in 1996, Bob has the right to sue Mary and John for contribution. He will probably have to bear the cost of that litigation as well as the risk associated with collecting upon any judgment he obtains. This policy does not entice responsible officers to step forward with payment but rather to stand back waiting and hoping that one of the others will pay willingly or by enforced collection. For a

It is not uncommon for the inquiry into the liability under I.R.C. section 6672 to take several months after the taxes were due and the inquiry itself lasts several months longer. So by the time the IRS makes an assessment against a responsible officer, one or two years have passed since the return for the collected taxes was due and since interest (and penalties) began accruing on the underlying tax obligation of the entity.²³

This paper presumes collected taxes went unpaid by the entity and that one or more persons were responsible for that underpayment. As mentioned above the tests for who is liable for the 6672 penalty involve both responsibility and willfulness. Much has been written on these tests and on other aspects of this liability;²⁴ however, for purposes of the discussion in this paper, liability exists leaving the question of payment and more precisely the payment of interest on the obligation.

A. AN EXAMPLE

The example below illustrates the manner in which collection of the 6672 liability is collected in the current system.

ABC, Inc. employs 50 people. It has a quarterly payroll of \$300,000. ABC's management is lead by Bob Smith, President; Mary Jones, Vice President and John Doe, Treasurer. For the first quarter of 2008, ABC experienced a sharp dip in orders due to a recession in the US economy. The dip in orders led to cash flow problems at ABC. Bob, Mary and John met to discuss the cash flow problems. They decided that ABC could keep afloat without incurring significant additional bank debt if it delayed paying the payroll taxes to the IRS. So, instead of paying the \$75,000 in payroll taxes to the IRS, ABC mailed in its quarterly Form 941 reporting this amount of liability with no remittance. The \$75,000 in payroll taxes consist of three parts: the employer liability, withheld social security taxes and withheld income taxes. For purposes of this example, the withheld income taxes make up \$50,000 of this amount in each of the quarters and the

discussion of the intersection of incentives and tax compliance see Leslie Book, *Freakonomics and the Tax Gap: An Applied Perspective*, 56 AM. U. L. REV. 1163 (2007); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453 (2003).

23. The delay in IRS entry onto the scene is spelled out in detail in U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-617, TAX COMPLIANCE: BUSINESSES OWE BILLIONS IN FEDERAL PAYROLL TAXES, 7 (2008). The consequences of the delay are spelled out in 2006 NAT'L TAXPAYER ADVOCATE ANN. REP. vol. 1, at 69.

24. See DAVID M. RICHARDSON, JEROME BORISON & STEVE JOHNSON, CIVIL TAX PROCEDURE Ch. 14 (2nd ed. 2008) (2005); MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE, 17.07-09 (Warren Gorham Lamont 1991) (1981); McCall, *supra* note 16; Bedikian, *supra* note 16.

amount of the withheld social security taxes, also a collected tax subject to 6672, is ignored.

Although ABC's management expected an upturn in the second quarter that would allow them to catch up with the missed payment, things only got worse. Consequently, they again decided not to send into the IRS the payroll tax payment for the second quarter which again would have totaled \$75,000. The IRS continued not to bother the company. Management knew things would get better and that in the third quarter, they would catch up. Unfortunately, orders continued to decline as the year progressed. ABC was again unable in the third quarter to pay its payroll taxes of \$75,000. Other bills were also being delayed or being left unpaid. Creditors were calling at an ever increasing pace. Finally, in late September, ABC heard from the IRS asking where the payroll taxes were for the first three quarters. When ABC did not immediately pay the back payroll taxes, the IRS filed a notice of federal tax lien on September 25, 2008. The filing of that notice triggered the termination of the company's line of credit with the bank. Without that line of credit and with no ability to replace it, ABC could no longer meet payroll or pay for new goods. ABC closed its doors on September 30, 2008. At that time, it owed \$225,000 in payroll taxes of which \$150,000 stemmed from income taxes that it withheld from its employees.

In March 2009, having concluded that ABC could not pay the back payroll taxes, the IRS investigated ABC to determine why it did not pay its payroll taxes. The IRS determined that the failure to pay was due to decisions made by John, Mary and Bob. The IRS asked John, Mary and Bob to consent to the assessment of the 6672 penalty against them. Each of them told the IRS that they were not responsible for failing to pay over the withheld income and social security taxes withheld from the wages of the employees of ABC and that the problem was a direct result of decisions made by the other two parties. Each officer appealed the IRS determination of responsibility to the Appeals Office. In October 2009 a conference was held in the IRS appeals office with respect to each of their cases. The information exchange with the appeals officer and the time it took him to reach a conclusion meant that the decision to hold Bob, Mary and John liable under I.R.C. section 6672 came in February, 2010. The assessment against each of them for \$150,000 was made on April 30, 2010, two years after the due date of the return for the first quarter for which the withheld payroll taxes were not paid.

B. INTEREST ANALYSIS

Interest begins running on each of Bob, Mary and John's 6672 liabilities on April 30, 2010, the day of the assessment of the 6672 liability. The liability of ABC for these employment taxes arose on the payment of the employee wages. A failure to deposit penalty could be imposed against ABC beginning on the due date of the payment of the employment tax. That due date depends on the amount of the payroll. The due date of the return for each quarter marks the day on which interest begins to run against ABC on the outstanding employment taxes. The quarterly return is due on the last day of the month following the end of the quarter. For the quarter ending March 31, 2008, the liability for interest began running on April 30, 2008.

For purposes of this illustration, the amount of interest reflects only interest on the withheld income tax portion of the employment tax liability. Interest on \$50,000 from April 30, 2008 to April 30, 2010, at the applicable rate (using 5 percent simple interest for all quarters) would be \$5000.²⁵ Interest on the liability for the second quarter would run from July 31, 2008 and at the applicable rate would be \$4380. Interest on the liability for the third quarter would run from October 31, 2008 at the applicable rate would be \$3760. The total amount of interest due from ABC on the employment tax liabilities for these three quarters as of April 30, 2010, would be \$13,140. As of April 30, 2010, Bob, Mary and John owe \$0 in interest for the employment tax liabilities assessed against them with respect to the first three quarters of 2008 because the 6672 liability is treated as an assessable penalty for which interest does not begin until the liability is assessed.

25. The current interest rate does not use simple interest but interest that compounds daily so, if the assumed interest rate is correct, the total interest in a real case would, of course, be higher. I.R.C. § 6622(a).

The tax and interest liabilities in chart form are as follows:

| Period | Unpaid Employment Taxes | Withheld Income Tax Portion of Employment Taxes | Interest on Withheld Tax, Due Date of Return to Assessment of 6672 Liability |
|------------------------|-------------------------------|--|---|
| 1 st Q 2008 | \$75,000 | \$50,000 | \$5,000 |
| 2 nd Q 2008 | \$75,000 | \$50,000 | \$4,380 |
| 3 rd Q 2008 | \$75,000 | \$50,000 | \$3,760 |
| Total | \$225,000 ²⁶ | \$150,000 ²⁷ | \$13,140 ²⁸ |

As is seen in this example, the savings to the responsible officers resulting from the delay equals \$13,140. The current system not only causes the Treasury to forego revenue for the time value of money on the unpaid taxes. It also makes the administration of the laws much more difficult because the IRS must use its investigative powers to identify the individuals responsible for the failure to pay the employment taxes while those individuals do little to work with the IRS to resolve the matter.²⁹ Instead, they will do everything in their power to avoid resolving the matter since resolution not only means they have been tagged with the liability but also that the liability no longer exists in an interest-free setting.

26. Total unpaid employment taxes due from ABC.

27. Total amount of unpaid employment taxes due from ABC that represents collected taxes. This is the amount for which responsible persons may be held liable pursuant to I.R.C. § 6672.

28. Total interest owed on the unpaid collected taxes between date the liability arose – the due dates of the employment tax returns – and the date of the responsible officer assessments – April 30, 2010. This amount represents the amount owed by the entity for failing to pay over the collected taxes that is not charged under current federal law to the responsible officers because the liability of responsible officers for interest does not start until the date of the 6672 assessment while the liability of the entity for interest runs from the due date of the return.

This chart does not display other liabilities that would be due from the corporation that are not charged to the individual responsible officers under existing federal law but are charged to the individual responsible officers under the laws of most states. These liabilities are the failure to deposit penalty and the failure to pay penalty. The failure to deposit penalty arises under I.R.C. § 6656(a). The failure to pay penalty arises under I.R.C. § 6651(a)(2). In the aggregate these penalties would almost always exceed the amount of unpaid interest.

29. As seen below, in the section discussing state laws on this issue, the administration of this issue by the IRS will also prove more difficult in most states if the taxpayer or the taxpayer's representative is well informed since the first payments will go to the state to stop the running of interest and penalties there rather than to the IRS.

III. PURPOSE OF 6672

The legislative history of 6672 traces back to a penal statute. The penal nature displays itself in both civil and criminal manifestations. This history supports a reasonable inference that 6672's location in the 1954 Code in the assessable penalty provisions followed, or at least did not contradict, the purpose of the statute as developed in the decades prior to codification. In contrast to the legislative history, the purpose of 6672 as expressed in Congressional policy, in IRS policy and in court decisions is simply that 6672 serves as a backup mechanism for insuring payment of collected taxes. Furthermore, the Congressional, IRS and court expressions on the policy of 6672 make clear that this statute does not create a separate liability.

A. LEGISLATIVE HISTORY

Penal provisions imposing criminal liability for failure to pay over collected taxes were created in the Corporate Excise Tax Act of 1909.³⁰ Section 6672's history flows though the Revenue Act of 1916 shortly after the establishment of the modern tax system following the passage of the 16th Amendment.³¹ Like many tax provisions it traces this part of its history directly to a war—in this case World War I. Congress passed a criminal penalty which applied to violations relating to the failure to pay of certain excise taxes.³² At that time withholding of income taxes did not exist and excise taxes provided a substantial portion of the total federal tax revenues. Because this segment of 6672's history manifests itself as a criminal provision, interest did not come into play. The statute provided:

That whoever fails to make any return required . . . or who makes any false or fraudulent return, and whoever evades, or attempts to evade any tax . . . or fails to collect or truly to account for and pay over any such tax, shall be subject to a penalty of not more than \$1,000, or to imprisonment for not more than one year or both, at the discretion of the court, and in addition thereto a penalty of double the tax evaded, or not collected, or accounted for and paid

30. "That if any cosigner, seller . . . or other person . . . shall be guilty of any willful act or omission by means whereof the United States shall or may be deprived of the lawful duties, or any portion thereof, accruing upon the merchandise . . . such person or persons shall, upon conviction, be fined for each offense . . . or be imprisoned . . . or both" Corporate Excise Tax Act of 1909, Pub. L. No. 5, § 9, 36 Stat. 11, 97 (1909).

31. Act of Sept. 8, 1916, Pub. L. No. 271, ch. 463, § 16, 39 Stat. 756, 773-75. For a detailed discussion of the legislative history of 6672 see Moran, *supra* note 14, at 723-53.

32. Act of Sept 8, 1916, Pub. L. No. 271, §§ 200, 300, 400 and 500, 39 Stat. 756, 777-93.

over, to be assessed and collected in the same manner as taxes are assessed and collected in any case in which the punishment is not otherwise specifically provided.³³

In the Revenue Act of 1918, Congress enacted section 1308 creating three tiers of civil and criminal penalties applicable to non compliance with excise taxes.³⁴ The first tier, the civil tier, provided for a monetary penalty of up to \$1,000. The statute does not specifically tie the penalty to an amount of unpaid tax and in that respect looks more like a "regular" penalty.³⁵ The second tier began the criminal sanctions by creating a misdemeanor liability.³⁶ The third tier most closely resembles the current 6672 except that this third tier imposed a criminal liability. It hit the offending party with a "penalty of the amount of the tax evaded, or not paid, collected or accounted for and paid over"³⁷

The Revenue Act of 1924 made further changes.³⁸ The changes continued to move the language toward the current language and "[e]xcept for the minor phrase reversal from 'any person who willfully fails' of the 1924 Revenue Act to 'any person required to collect, . . . who willfully fails to collect' of present section 6672, the Revenue Act of 1924 represents the last substantive amendment to the language of what became section 6672."³⁹

In 1935, the passage of the Social Security Act expanded the scope of the penalty for failure to pay collected taxes making it applicable to unpaid Social Security taxes collected at the source in addition to excise taxes.⁴⁰

33. Act of Oct. 3, 1917, ch. 63, § 1004, 40 Stat. 300, 325-26.

34. Revenue Act of 1918, Pub. L. No. 254, ch. 18, § 1308(c), 40 Stat. 1057, 1143.

35. *Id.* ("That any person required under Titles V, VI, VII, VII, IX, X, or XII, to pay, or to collect, account for and pay over any tax, or required by law or regulations made under authority thereof to make a return or supply any information for the purposes of the computation, assessment or collection of any such tax, who fails to pay, collect, or truly account for and pay over any such tax, make any such return or supply any such information at the time or times required by law or regulation shall in addition to other penalties provided by law be subject to a penalty of not more than \$1,000.").

36. *Id.*

37. *Id.* The statute also contains a definitional provision similar to current section 6672 – "The term person as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs." *Id.*

38. Revenue Act of 1924, Pub. L. No. 176, ch. 234, 43 Stat. 253.

39. Moran, *supra* note 14, at 740-41. See also Revenue Act of 1928, Pub. L. No. 562, ch. 852, § 146, 45 Stat. 791, 835; see also Revenue Act of 1924, Pub. L. No. 176, ch. 234, § 1017(d), 43 Stat. 253, 344. Section 1017(d) provides: "Any person who willfully fails to pay, collect or truthfully account for and pay over, any tax imposed by Titles IV, V, VI, VII, and VIII, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected."

40. Act of Aug. 14, 1935, Pub. L. No. 271, ch. 531, § 807(c), 49 Stat. 620, 638 (stating: "All provisions of law, including penalties, applicable with respect to any tax imposed by section 600 [excise tax provisions] . . . of the Revenue Act of 1926, . . . shall, insofar as applicable and not inconsistent with

This penalty was codified in 1939 and “remained intimately and exclusively related to the criminal sanctions until its ‘civil’ pigeonholing in the 1954 Code.”⁴¹

In the same year it passed the Social Security Act, 1935, Congress brought into the Internal Revenue Code the predecessor of current section 7501.⁴² Section 7501 provides that “the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States.” The goal behind the statute centered on a desire to make administrative assessment and collection provisions available and to provide further protection for the collected funds.⁴³

Just as World War I caused Congress to create the criminal penalty predecessor of 6672, World War II inspired another change which significantly impacted the penalty for failure to pay over collected taxes. The Current Tax Payment Act of 1943 created the regime of tax collection from employees that still exists today.⁴⁴ Congress once again grafted the withholding tax provisions into the penalty regime initially set up for excise taxes expanding this collected tax penalty provision to reach essentially the same provisions it currently covers.⁴⁵

The next act in the progression of the collected tax penalty to its modern provision occurred in the codification effort in 1954.⁴⁶ In this effort the penalty for collected taxes moved into Subtitle F, subpart B—Assessable Penalties of the newly revised Internal Revenue Code.⁴⁷ The legislative history of 6672 contains basically no explanation concerning the placement of the civil liability creating personal liability for failure to pay collected taxes in the assessable penalty section of the newly revised Code.⁴⁸ The positioning of 6672 in the assessable penalty subpart of the

the provisions of this title, be applicable with respect to the taxes imposed by this title.”).

41. Moran, *supra* note 14, at 747.

42. Revenue Act of 1934, Pub. L. No. 216, ch. 277, § 607, 48 Stat. 680, 768.

43. S. REP. NO. 73-558, at 53 (1934). The Supreme Court interpreted the scope of this trust and detailed the history behind the creation of the provision in *Begier v. Internal Revenue Service*, 496 U.S. 53 (1990).

44. Current Tax Payment Act of 1943, Pub. L. No. 68, ch. 120, 57 Stat. 126.

45. Moran, *supra* note 14, at 748 n.138. As noted in Professor Moran’s article at footnote 138, no judicial interpretation of the penalty for collected taxes had yet occurred.

46. See *Regan & Co., Inc. v. United States*, 290 F.Supp. 470, 479-80 (E.D.N.Y. 1968) for a discussion of the broad scope of 6672 as it tied together more narrowly crafted statutes imposing similar liabilities in piecemeal fashion.

47. Internal Revenue Code of 1954, Pub. L. No. 591, 68A Stat. 3, 828. At the same time section 7202 was enacted in Subtitle F, subpart A—crimes creating a criminal liability for similar conduct but with penalty provisions that did not incorporate the 100 percent liability for the unpaid tax. *Id.* at 851; see also Moran, *supra* note 14, at 750.

48. Moran, *supra* note 14, at 750; H.R. REP. NO. 83-1337 (1954), as reprinted in, 1954 U.S.C.C.A.N. 4017, 4025 (“This revision includes a rearrangement of the provisions to place them in more logical sequence, the deletion of obsolete material, and an attempt to express the internal revenue laws in a more understandable manner.”).

Code together with the absence of any specific language in 6672 concerning interest has led to the current state of affairs in which interest does not accrue until the liability is assessed. None of the changes to 6672 since 1954 have addressed the issue of interest. Its placement within subpart B of Subtitle F has remained unchanged.

Assessable penalties generally exist separate from taxes imposed under the Internal Revenue Code. Because these penalties do not relate to a specific tax, they do not relate back to a specific return due date or taxable event.⁴⁹ Assessable penalties generally stand alone as their own separate liability with the exception of 6672. Consequently, a separate interest provision imposes interest from the time these penalties arise—at the time of their assessment.⁵⁰

B. CONGRESSIONAL POLICY

The expression of Congressional policy concerning 6672 discussed here will focus on the bankruptcy provisions concerning the liability for collected taxes. Congressional policy expressed through the Bankruptcy Code demonstrates that almost no liability shares the importance of collected taxes.

Creditors in bankruptcy cases basically belong to one of two groups: secured or unsecured. Generally, secured creditors who do not sleep on their rights have little concern about bankruptcy because they look to their security rather than the debtor's solvency for repayment. Unsecured creditors, however, have much to fear from bankruptcy since so many debtors have little or no unencumbered assets with which to repay their unsecured debts. Congressional policy addresses the plight of the unsecured creditors by making some of them more equal than others. The provisions that differentiate unsecured creditors come in two forms: priority status and exceptions to discharge.

Bankruptcy Code section 507(a) sets forth a list of unsecured creditors that Congress has designated as entitled to payment before other unsecured creditors. Placement of an unsecured creditor on this list significantly improves its chances of receiving payment through the bankruptcy proceeding. The higher on the list created by 507(a) an unsecured creditor achieves, the more likely it will receive payment.⁵¹

49. IRS Chief Counsel Advice 200112003, 2001 WL 283666 (Nov. 28, 2000); *Sage v. United States*, 908 F.2d 18 (5th Cir. 1990).

50. I.R.C. § 6601(e)(2) provides that interest is only imposed on an assessable penalty if the person assessed such penalty fails to pay the liability after receiving notice and demand.

51. COLLIER ON BANKRUPTCY, Ch. 507.2 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. 2008); MICHAEL HERBERT, UNDERSTANDING BANKRUPTCY, Ch. 10.04 (Bender 2000).

In a similar manner, Bankruptcy Code section 523(a) creates a list of unsecured creditors whose debts Congress has determined receive an exception to discharge. Creditors on this list may continue to seek collection from individual debtors even after the individual debtor has obtained a discharge from the bankruptcy court.⁵² Every unsecured creditor wants recognition on this list because the “next best thing” to receiving payment through the bankruptcy estate is having the continued ability to pursue collection after discharge. Some unsecured creditors have sufficient fortune or influence to have their debt recognized as both a priority debt and one excepted from discharge.⁵³

With the exception of the liability imposed by 6672, assessable tax penalties do not make the priority list in Bankruptcy Code section 507(a).⁵⁴ An unsecured claim for an assessable penalty receives general unsecured classification rather than receiving any priority. Assessable penalties and tax penalties in general receive even worse treatment than a general unsecured classification for cases administered under Chapter 7.⁵⁵ In Chapter 7 cases, these penalties only receive payment after all general unsecured claims have been paid.⁵⁶ This sub-general unsecured classification even applies to penalty claims for which a notice of federal tax lien was filed and would, except for their origin in the penalty provisions, receive secured status.⁵⁷

Although assessable penalties do not receive priority claim classification, they do receive an exception to discharge pursuant to B.C. 523(a)(7).⁵⁸ To qualify for an exception to discharge, an assessable penalty

52. COLLIER ON BANKRUPTCY, Ch. 523.01; DAVID EPSTEIN, BANKRUPTCY AND RELATED LAW IN A NUTSHELL, Ch. XVII, Sec. B (West 2005) (2002).

53. Letter from David Lindsay, Assistant to the Secretary of the Treasury, to Emanuel Celler, Chairman of the House Committee on the Judiciary (June 24, 1959), in H.R. REP. NO. 86-735, at 6 (1959); Letter from Stanley Surrey, Assistant Secretary of the Treasury, to Emanuel Celler, Chairman of the Senate Committee on the Judiciary (July 14, 1961), in S. REP. NO. 89-114, at 7 (1965); Letter from Stanley Surrey, Assistant Secretary of the Treasury, to James Eastland, Chairman of the Senate Committee on the Judiciary (Aug. 24, 1961), in S. REP. NO. 89-114, at 10.

54. 11 U.S.C.A. § 507(a)(8)(C) (West 2004) provides priority status for collected taxes, “a tax required to be collected or withheld and for which the debtor is liable in whatever capacity.” This discussion focuses on federal tax liability; however, essentially the same results would occur with respect to state tax liabilities. Subsequent references to “B.C.” refer to the Bankruptcy Code as enacted in Title 11 of the United States Code.

55. 11 U.S.C.A. §§ 726(a)(4), 724(a) (West 2004).

56. 11 U.S.C.A. § 726(a)(4).

57. 11 U.S.C.A. § 724(a) (West 2004).

58. 11 U.S.C.A. § 523(a)(1)(A) (West 2004) provides an exception to discharge for collected taxes because collected taxes receive priority treatment pursuant to B.C. 507. Because assessable penalties, other than 6672, do not receive priority treatment pursuant to B.C. 507, they do not meet the test of B.C. 523(a)(1)(A). They also do not meet the tests of B.C. 523(a)(1)(B) or (C). Assessable penalties do meet the test of B.C. 523(a)(7). Only one reported decision specifically addresses the application of the exception to discharge to assessable penalties other than 6672. This decision was subsequently withdrawn. *Nielsen v. United States*, No. 3-88-3164-H, 1991 WL 101552 (N.D. Tex. Apr 19, 1991),

must relate to an act or a return due date that occurred within three years before the filing of the bankruptcy petition. The exception to discharge that applies to assessable penalties arises under a different subparagraph than the exception to discharge applicable to 6672. The exception to discharge applicable to 6672 is much preferred because of the lack of a time limitation.

As further discussed below, the treatment of the liability imposed by 6672 is not only different and more favorable than the treatment of other assessable penalties; it is more favorable than the treatment of almost any other unsecured liability. This special treatment appears to result from Congressional recognition of the importance of the payment of collected taxes.⁵⁹

A debate concerning the treatment of 6672 in bankruptcy occurred in the late 1950s and early 1960s when proposals were pending in Congress to reform the discharge provisions to reduce or eliminate the broad exception to discharge then available to taxes.⁶⁰ In 1961, Assistant Secretary of the Treasury Stanley S. Surrey wrote to Senator Eastland, the Chairman of the Senate Committee on the Judiciary: "Delinquency in this area has increased in recent years, and the Department considers it most undesirable to permit persons who are charged with the responsibility of paying over to the Federal Government moneys collected from third persons to be relieved of their obligations in bankruptcy when they have converted such moneys for their own use."⁶¹

In 1966 Congress did scale back the discharge exception previously granted for taxes but added subsection (e) to Section 17a(1) of the Bankruptcy Act.⁶² Prior to the 1966 amendments, all taxes basically benefited from the exception to discharge in bankruptcy. This broad exception provoked significant complaints from the bankruptcy bar and certain commercial interests. With the passage of the amendments in 1966, the exception to discharge for taxes took on a form similar to that carried into the current Bankruptcy Code, that is, the exception primarily applies to

withdrawn, Nielson v. United States, No. 3-88-3164-H, 1991 WL 107412 (N.D. Tex. May 09, 1991); I.R.S. Litigation Guideline Mem. GL-36, Effect of Bankruptcy Case upon I.R.C. 6700, 6701, 6702, and 7408 (Apr. 24, 1998).

59. S. REP. NO. 95-989, at 14 (1978).

60. Letter from David Lindsay, Assistant to the Secretary of the Treasury, to Emanuel Celler, Chairman of the House Committee on the Judiciary (June 24, 1959), *in* H.R. REP. NO. 86-735, at 6 (1959); Letter from Stanley Surrey, Assistant Secretary of the Treasury, to Emanuel Celler, Chairman of the Senate Committee on the Judiciary (July 14, 1961), *in* S. REP. NO. 89-114, at 7 (1965); Letter from Stanley Surrey, Assistant Secretary of the Treasury, to James Eastland, Chairman of the Senate Committee on the Judiciary (Aug. 24, 1961), *in* S. REP. NO. 89-114, at 10; H.R. 2236, 86th Cong. (1959); S. 976, 89th Cong. (1965).

61. S. REP. NO. 89-114, at 10. *See also* H.R. REP. NO. 88-372, at 6 (1963).

62. S. REP. NO. 89-114, at 16-18

taxes incurred within three years of the filing of the bankruptcy petition.⁶³

A new section 17a(1)(e) provided: "That a discharge in bankruptcy shall not release a bankrupt from any taxes . . . , which the bankrupt has collected or withheld from others as required by the laws of the United States . . . but has not paid over" ⁶⁴ As the House Committee explained in reporting out the measure, the purpose of the amendment was "to exempt from the provisions of this bill taxes which the bankrupt has collected or withheld from others under Federal or State law."⁶⁵ In the House Committee's view, "[t]he objection of Treasury to the discharge of so-called trust fund taxes has been met by the amendment to this bill."⁶⁶ Likewise, the Senate Reports confirm that the purpose of Section 17a(1)(e) was to render trust fund taxes nondischargeable in bankruptcy.⁶⁷

In the 1970s Congress spent several years creating a new bankruptcy code to replace the Bankruptcy Act of 1898.⁶⁸ In creating the new bankruptcy code, Congress reviewed, *inter alia*, the types of unsecured debts that should receive priority status and that should receive an exception to discharge.⁶⁹ Ultimately, the type of debt it singled out for an exception to discharge in 1966, collected and withheld taxes including the 6672 liability, received special recognition in the new bankruptcy code as a priority tax claim and as a claim excepted from discharge.⁷⁰ Not only did 6672 receive priority status under the bankruptcy code enacted in 1978 when no other assessable penalty achieved such status, the liability imposed under 6672, and for any unpaid collected tax, also received better treatment under the bankruptcy code than any other tax of any type.⁷¹

A taxpayer entering bankruptcy with unpaid income, employment or excise taxes, other than taxes of those types collected from others, essentially has a time limit cap on the life of that liability before it loses its

63. H.R. 3438, 89th Cong., 80 Stat. 270 (1966).

64. Pub. L. No. 89-496, 80 Stat. 270.

65. H.R. REP. NO. 88-372, at 1.

66. *Id.* at 5.

67. S. REP. NO. 88-1134, at 1, 6 (1964); S. REP. NO. 89-114, at 6 (1965); Brief of Petitioner-Appellant at 17-18, *United States v. Sotelo*, 436 U.S. 268 (1978) (No. 76-1800).

68. S. REP. NO. 95-989, at 1-4 (1978).

69. Congress created a commission to review the bankruptcy laws and make recommendations. S.J. Res. 88, 91st Cong., 84 Stat. 468 (1970). That commission's initial recommendation concerning taxes proposed a very limited exception to discharge for taxes including collected taxes. "The principal revisions are, first, the reduction from three years to one year of the time period for the nondischargeability and priority of tax debts, and, second, the shift from reference to 'due and owing' and 'assessed' to special rules tailored to major categories of the debts." H.R. DOC. NO. 93-137, pt. 2, at 138 (1973).

70. S. REP. NO. 95-989, at 14 (1978); H.R. REP. NO. 95-595, at 191 (1977).

71. Basically, all other prepetition unsecured taxes received a time limited grant of priority status and a time limited exception to discharge. See 11 U.S.C.A. §§ 507(a)(8), 523(a)(1) (West 2004 & Supp. 2008).

status as an unsecured priority claim.⁷² The time limit essentially makes income, employment or excise taxes older than three years at the time of the bankruptcy petition, general unsecured claims rather than claims entitled to unsecured priority status. Contrast that with the treatment of the 6672 liability and the liability for unpaid collected taxes. A taxpayer entering bankruptcy with unpaid 6672 liabilities has a liability that will receive unsecured priority status no matter how old the 6672 liability is at the time of the bankruptcy petition.

Granting the 6672 liability unsecured priority status no matter its age provides significant recognition of the importance of this liability from Congress' viewpoint. Priority status gives the government a much greater chance to receive payment on this liability from the bankruptcy estate that it would have as a general unsecured claim. The unlimited time period for priority status also means that the 6672 liability will always receive the exception to discharge under B.C. 523(a)(1) while other taxes lose their exception to discharge with age. The combination essentially makes it impossible to get rid of the 6672 liability through bankruptcy. This total protection from bankruptcy evinces a significant policy statement by Congress concerning the importance of this liability. No other tax and almost no other liability receive this type of protection.

In 2005 Congress addressed the protection for the 6672 liability again in order to close a loophole that had arisen through case law. The change in 2005 once again demonstrated Congress' view of the importance of this type of liability. The change occurred in the discharge provisions of Chapter 13.⁷³ Persons liable under 6672 are not always known to the IRS at the time they file a bankruptcy petition because the liability is a derivative liability. Generally, the IRS does not know who has liability under 6672 until it investigates a company after it has failed to pay over the collected taxes. Because the identity of the debtor as a responsible officer is not known by the IRS prior to the bar date, it fails to file a timely proof of claim. The failure to file a timely proof of claim does not affect the exception to discharge in Chapter 7 and 11 cases of individuals because the exception ties itself to the status of the IRS claim and not whether the IRS timely filed such a claim.

The IRS argued for a similar result in Chapter 13 but lost that argument in *Tomlan v. United States*.⁷⁴ The IRS failed to timely file its

72. See 11 U.S.C.A. § 507(a)(8)(A) for income taxes; section (D) for employment taxes; and section (E) for excise taxes. 11 U.S.C.A. §§507(a)(8)(A), (D), (E) (West 2004 & Supp. 2008). With respect to each type of tax the time limit is generally three years from the due date of the return or the event giving rise to the tax liability.

73. 11 U.S.C.A. § 1328(a) (West Supp. 2008); H.R. REP. No. 109-31, at 101 (2005).

74. *Tomlan v. United States* (In re Tomlan), 102 B.R. 790 (E.D. Wash. 1989), *aff'd per curiam*, 907 F.2d 114 (9th Cir. 1990).

claim in *Tomlan*. The debtor's plan proposed to pay in full all timely filed priority claims. The District Court found that the plan discharged the debtor's liability under 6672 because of the finality of the plan and the wording of B.C. 1328(a).⁷⁵ The IRS essentially acquiesced in the decision in the publication of its litigation position on the issue;⁷⁶ however, it sought to change 1328(a) when Congress appointed a Commission in 1994 to look into changes to the bankruptcy code.⁷⁷ When Congress ultimately passed the laws resulting primarily from the proposals of the Commission in the 2005, those bankruptcy amendments included a provision addressing this concern of the IRS.⁷⁸ The result of this process is a change to 1328(a) that prevents discharge of the liability imposed under 6672 in a Chapter 13, whether or not the IRS files a timely claim.

Congressional policy toward 6672 as expressed in bankruptcy code provisions from 1966 to 2005 could not more strongly suggest how important Congress views the requirement to pay the collected taxes and how different 6672 is from any other assessable penalty. Its difference comes from its status as an alternate means for the government to collect those taxes which have been collected for it and which should be held in trust and paid over to the government.

C. IRS POLICY

The principal IRS position concerning 6672 comes in policy statement P-5-14.⁷⁹ This policy statement currently provides that "[t]he withheld employment and income taxes or collected excise taxes will be collected only once, whether from the business, or from one or more of its responsible persons."⁸⁰ This policy statement goes back to 1956.⁸¹ The Supreme Court has cited to the policy statement⁸² and to a Comptroller General Opinion based on this policy statement in describing the purpose of 6672.⁸³

75. *In re Tomlan*, 102 B.R. at 796.

76. I.R.S. Litigation Guideline Mem. GL-37, Dischargeability of Untimely Filed Liabilities in Chapter 13 Bankruptcies (Apr. 7, 1992) (obsoleted Jan. 13, 1998).

77. Jack Williams, *A Comment on the Tax Provisions of the National Bankruptcy Review Commission Report: The Good, The Bad and the Ugly*, 5 AM. BANKR. INST. L. REV. 445, 455 (1997).

78. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 707, 119 Stat. 23, 126; 11 U.S.C.A. § 1328(a) (West Supp. 2008).

79. Policy Statement P-5-14 was renumbered and slightly rewritten in 2003. Prior to that it was Policy Statement P-5-60.

80. I.R.M. 1.2.14.1.3 (June 9, 2003).

81. I.R.S. Policy Statement P-5-60, MT 1218-56 (Approved Nov. 5, 1956); see *McCarty v. United States*, 437 F.2d 961 (Ct. Cl. 1971) (discussing related Internal Memorandum No. 56-46).

82. *Slodov v. United States*, 436 U.S. 238, 245-46 (1978).

83. *United States v. Sotelo*, 436 U.S. 268, 280 n.12 (1978).

The policy of the IRS regarding 6672 has remained constant for over fifty years.⁸⁴ The IRS imposes the 6672 liability against all of the persons responsible for the failure to pay a collected tax. Consequently, it may have assessments on its books for the original liability due from a corporation plus one or more assessments of the amount of the unpaid collected taxes against persons responsible for the corporation's failure to pay those collected taxes over to the IRS. Despite having numerous assessments and despite the apparent ability under 6672 to collect the full amount from each party, the IRS has consistently said that it will not use 6672 as a mechanism for collecting the full amount of the unpaid collected taxes from each party assessed. Rather, it takes the view that 6672 is simply a device for the collection of the unpaid taxes collected by the corporation. It is not a separate liability. As such, the IRS seeks to collect only once from either the corporation or any of the responsible persons.⁸⁵

Using the example of Bob, Mary, and John as responsible officers of ABC for three quarters of 2008 for a total of \$150,000 in unpaid collected taxes, an illustration is possible. Once the IRS makes the responsible officer assessments against Bob, Mary and John it will have four assessments on its books for the recovery of this same \$150,000. Because of the policy statement, the IRS links these four accounts in order to insure that it only collects \$150,000 in tax (plus any applicable penalties and interest).⁸⁶ This policy leads to the IRS position on repayment of proceeds received in excess of one full payment of the tax. If Bob, Mary and John are each assessed a \$150,000 6672 liability on March 10, 2010, each owes \$150,000 at that moment. Suppose Bob pays the \$150,000 that day at 10:00 a.m., Mary pays the \$150,000 at 11:00 a.m. and John pays the \$150,000 at noon. After a thorough investigation to ascertain when the payments were received, the IRS would refund to Mary and John their entire payments leaving Bob as the person who paid it all.⁸⁷ If Bob wishes to have Mary and John contribute to 6672 liability, he must bring a separate suit against each of them for that purpose, obtain a judgment and successfully collect on the judgment.⁸⁸

The IRS policy toward 6672 does not match its policy with respect to any of the other assessable penalties. For all other assessable penalties, the IRS seeks to collect the total amount of the taxes assessed. Unlike 6672,

84. I.R.S. Service Center Advisory, 2000 WL 33116108 (June 30, 2000).

85. See Bryan T. Camp, *Avoiding the Ex Post Facto Slippery Slope of Deer Park*, 3 AM. BANKR. INST. L. REV. 329, 330-32 (1995) for a general discussion of the nature of the 6672 liability and how the IRS seeks to collect it.

86. I.R.S. Service Center Advisory, 2000 WL 33116108 (June 30, 2000).

87. The SCA covers the repayment to taxpayers from the IRS but does not mention what happens between parties when only one pays. Suing other parties to recover a party's share of the liability is included in IRC §6672(d).

88. *Id.*

the other assessable penalties are separate and distinct from any taxes to which they may relate. The other assessable penalties perform a penal function rather than a function to recover unpaid taxes.

D. COURT DECISIONS

Two court decisions provide significant insight into the view courts take toward 6672. These decisions adopt the IRS policy that 6672 exists as a collection device and, in one, reinforce the Congressional policy view concerning the importance of 6672.

1. United States v. Sotelo⁸⁹

Arising in bankruptcy, *Sotelo* presented the Supreme Court with the opportunity to consider the nature and purpose of 6672. Mr. Sotelo filed his bankruptcy petition in 1973 when the Bankruptcy Act (rather than the current Bankruptcy Code) was in effect. He initially contested the determination that he owed the government pursuant to 6672; however, he did not appeal the determination that he was liable. Instead, he shifted his argument to one based on discharge arguing that the Bankruptcy Act 17a(1)(e) discharged penalties imposed under 6672. Although he lost at the bankruptcy court and district court level, he prevailed on this argument before the Seventh Circuit.⁹⁰

First, Mr. Sotelo argued that “the liability described in 6672 itself as a ‘penalty’ and as such had been discharged in bankruptcy.”⁹¹ Second, he argued that section 17a(1)(e) of the Bankruptcy Act did not except from discharge the penalty imposed under 6672 but rather excepted from discharge only the liability for collected taxes due from the corporation that incurred the debt.⁹²

The Supreme Court examined both the history of the 1966 amendments to the Bankruptcy Act as well as the purpose of 6672 as it related to the 1966 amendments. Through that examination it determined that the Mr. Sotelo’s 6672 liability was excepted from discharge by section 17a(1)(e) of the Bankruptcy Act.⁹³ It further determined that the penalty

89. *United States v. Sotelo*, 436 U.S. 268 (1978).

90. *In re Sotelo*, 551 F.2d 1090 (7th Cir. 1977).

91. *Sotelo*, 436 U.S. at 271; Brief of Respondent-Appellee at 5, *United States v. Sotelo*, 436 U.S. 268 (1978) (No. 76-1800).

92. Brief for the Respondent, *supra* note 91, at 8.

93. “The fact that respondent was found liable under 6672 necessarily means that he was ‘required to collect, truthfully account for, and pay over’ the withholding taxes, and that he willfully failed to

label placed on 6672 by the Internal Revenue Code did not matter when the Court analyzed the language and purpose of Bankruptcy Act 17a(1)(3).⁹⁴ Through this analysis, the Court determined that 6672 acted as a device for collecting the types of taxes described in 17a(1)(e).⁹⁵ As such, simply seeking to label 6672 as a penalty did not advance the taxpayer's argument because the label did not control the true purpose of 6672 as it related to the discharge provisions in Bankruptcy Act 17a(1)(e).⁹⁶

The Court did not explicitly say that 6672 is not a penalty. Instead, it focused on how 6672 operated with respect to the language of the discharge provision. In doing so, the Court did quote from a letter prepared in 1976 by the Comptroller General concerning IRS practices with regard to 6672; "IRS uses the 100-percent penalty only when all other means of securing the delinquent taxes have been exhausted. It is generally used against responsible officials of corporations that have gone out of business. . . . [I]t is IRS policy that the amount of the tax will be collected only once. After the tax liability is satisfied, no collection action is taken on the remaining 100-percent penalties."⁹⁷

The dissent in this 5-4 decision disagreed strongly that the "taxes" excepted from discharge in Bankruptcy Act 17a(1)(e) equated to the "penalty" imposed by 6672.⁹⁸ The dissent pointed to the legislative history of 6672 in support of the penal underpinnings of the statute.⁹⁹ The harsh result that the majority opinion created for the individual business owner by holding the 6672 liability as an exception to discharge was cited as support for the wrong policy direction taken by the majority. In stark terms¹⁰⁰ the dissent described the same bankruptcy result, made much clearer in the legislative history of the Bankruptcy Code that is described above in Section 3.B. While the dissent expresses its significant concerns that

meet one or more of these obligations." *Sotelo*, 436 U.S. at 274. "It is therefore clear that the 6672 liability was not imposed for a failure on the part of respondent to collect taxes but was rather imposed for his failure to pay over taxes that he was required both to collect and to pay over. Under these circumstances, the most natural reading of the statutory language leads to the conclusion that respondent 'collected or withheld' the taxes within the meaning of Bankruptcy Act 17a(1)(e)." *Id.* at 275.

94. "The funds here involved were unquestionable 'taxes' at the time they were 'collected or withheld from others.' . . . That the funds due are referred to as a 'penalty' when the government later seeks to recover them does not alter their essential character as taxes for purposes of the Bankruptcy Act." *Id.* at 275.

95. *Id.* at 279.

96. *Id.* at 280.

97. *Id.* at 280 (quoting United States Comptroller General Opinion, B-137762 (May 3, 1977), in 9 Standard Federal Tax Reporter, ¶ 6614, (CCH) 71,438 (1977)).

98. *Sotelo*, 436 U.S. at 287.

99. *Id.* at 288.

100. "[T]he *lifelong liability* which the Court imposes today falls on the shoulders of one who was the chief executive officer of a small family business. . . ." *Sotelo*, 436 U.S. at 290-91 (emphasis added).

neither the language of the Bankruptcy Act nor the policies behind it could support the majority's decision, Senator DeConcini made it clear just a few months later in his explanation of the Bankruptcy Code that the position adopted by the majority in *Sotelo* was the position adopted for the new legislation.¹⁰¹

2. *Lauckner v. United States*¹⁰²

The government discovered that Mr. Lauckner met the tests as a responsible officer of AAA Trucking Corporation. The discovery, however, came after the previously presumed date on which the statute of limitations expired for making a 6672. Prior to *Lauckner*, the government used as the statute of limitation for the 6672 liability the date on which the statute expired with respect to additional assessments against the corporation that failed to pay the collected taxes. In support of its assessment after the date on which one could be made against the corporation, the government argued that 6672 was an assessable penalty and, as such, did not have a statute of limitations on assessment. Mr. Lauckner argued that the assessment was time barred citing the previous position of the IRS concerning the statute of limitations for the 6672 liability.

The only Circuit Court addressing the issue of the statute of limitations on assessment of the liability imposed by 6672 determined that the government does not have an unlimited amount of time to assess this liability, as with other assessable penalties, but has a limitations period established by the underlying liability with respect to the corporation that collected the unpaid tax.¹⁰³ This determination, having nothing specifically to do with interest on the 6672 liability, aligns perfectly with the position that interest on the 6672 liability should not look to the interest provisions

101. See 1978 U.S.C.C.A.N. 6505, 6566:

Statement by the Hon. Dennis DeConcini, Chairman of the subcommittee on improvements in judicial machinery of the Senate Committee on the Judiciary, upon introducing the Senate Amendment to the House Amendment to H.R. 8200 . . . Taxes which the debtor was required by law to withhold or collect from others and for which he is liable in any capacity, *regardless of the age of the tax claims* . . . In addition, this category includes the liability of a responsible officer under the Internal Revenue Code (sec. 6672) . . . and the priority will cover the debtor's responsible officer liability regardless of the age of the tax year to which the tax relates. The U.S. Supreme Court has interpreted present law to require the same result as will be reached under this rule. *U.S. v. Sotelo*, 436 U.S. ____ (1978). This category also includes the liability under section 3505 of the Internal Revenue Code of a taxpayer who loans money for the payment of wages or other compensation. (Emphasis added).

102. *Lauckner v. United States*, No. 93-1594, 1994 WL 837464, at *7 (D.N.J. May 4, 1994), *aff'd per curiam*, 68 F.3d 69 (3d Cir. 1995).

103. *Id.*

applicable to assessable penalties but rather should run from the due date of the return giving rise to the liability.

No specific code section sets out a statute of limitations for the assessment of the 6672 liability.¹⁰⁴ For many years the IRS took the position that the statute of limitations on assessment of the 6672 liability mirrored the statute of limitations for the underlying tax and ran for three years from April 15 of the year following the end of the quarter in question.¹⁰⁵ This position followed the general rule found in 6501. Section 6501, however, applies to liabilities based on tax returns.

Probably because of a series of victories regarding the statute of limitations in cases under 6700 and 6701,¹⁰⁶ in 1994 the IRS suddenly seemed to come to the realization that 6672 was placed into the Code as an assessable penalty that was not based on a tax return. It then concluded that 6672 was a statute without a controlling provision with respect to the statute of limitations and made an assessment that would have been time barred under its previous interpretation of the statute of limitations as it applied to 6672.¹⁰⁷

To support its "new" position, the IRS made numerous arguments, all of which were rejected. First, the IRS argued that the 6672 liability constitutes a "separate and distinct" liability from the I.R.C. 3403 liability imposed on the employer.¹⁰⁸ The opening paragraph of the *Lauckner*

104. See I.R.S. CCA 200112003 (March 23, 2001) for a general discussion of the statute of limitations on penalties in subchapter 68B and a specific discussion of whether a statute of limitation on assessment of the penalty imposed under 6707 exists.

105. *United States v. Hodgekins*, 805 F. Supp. 653, 658 (N.D. Ind. 1992); *Turk v. United States*, No. S92-307M, 1993 WL 497785, at *6 (N.D. Ind. Sept. 17, 1993); *Stallard v. United States*, 12 F.3d 489, 493 (5th Cir. 1994).

106. See *Mullikin v. United States*, 952 F.2d 920, 933 (6th Cir. 1991); *Lamb v. United States*, 977 F.2d 1296, 1297 (8th Cir. 1992); *Capozzi v. United States*, 980 F.2d 872, 875 (2d Cir. 1992); *Sage v. United States*, 908 F.2d 18, 25 (5th Cir. 1990).

107. *Lauckner v. United States*, No. 93-1594, 1994 WL 837464, at *7 (D.N.J. May 4, 1994), *aff'd per curiam*, 68 F.3d 69 (3d Cir. 1995).

108. Numerous authorities exist for the proposition that the liability under 6672 is separate and distinct from the liability of the entity for the collected taxes. None of the authorities set the issue up in quite the way that *Bradley v. United States*, 936 F.2d 707, 710 (2nd Cir. 1991) does. In *Bradley* the IRS assessed 6672 liabilities against two individuals, Charles Bradley and David Agnew, for failure of Maxim Industries, Inc. (Maxim) to pay withheld employment and social security taxes. *Id.* at 709. After the 6672 assessments were made against Bradley and Agnew they paid a portion of the tax, filed a claim for refund and then filed suit. *Id.* Also after the 6672 assessments were made, Maxim filed a Chapter 11 bankruptcy petition. *Id.* Because it appeared that Maxim might have sufficient funds to fully pay the outstanding employment tax liability through the bankruptcy case, the parties in the refund suit agreed to dismiss the refund suit subject to reinstatement. *Id.* Maxim did pay all of the employment taxes through the bankruptcy case together with all of the interest for which it was liable; however, because interest does not accrue in Chapter 11 bankruptcy cases on unsecured claims between the date of the petition and the confirmation of the plan, the IRS sought to collect the interest for this period of time from the two responsible officers. *Id.* They resisted and the refund suit was reinstated setting up the issue of whether the IRS could do so. *Id.* at 708.

The Second Circuit laid out the issue as follows: "Essentially, plaintiffs contend that since

opinion sets the tone for the court's view of the government position; however, its rejection of the government's position stems from exactly the reasoning that supports imposing interest on the responsible officer equal to the interest on the entity. In describing the nature of the liability under 6672, the court stated "[a]s of the moment payment was due and not made, both the employer and any responsible officer became liable."¹⁰⁹

The court found that "it seems clear that courts have based the lower standard of conduct necessary to trigger § 6672 liability [for willfulness] on their understanding, unchallenged until now, that § 6672 functions only as a collection device, not as a truly 'separate and distinct' penalty."¹¹⁰ The court went on to hold that the 6672 assessment is separate only for purposes of collection.

The government argued that "because the responsible person assessed under § 6672 files no return with respect to the assessment, the assessment is not made with respect to any return, and the § 6501(a) limitations period on assessments is never triggered."¹¹¹ On this issue the court found, however, that the 6672 liability was in fact based on the employment tax return triggering the running of the statute of limitations under 6501. It examined several cases that had noted 'no return' is filed concerning 6672 liabilities and determined that "[t]hese cases do not stand for the proposition that § 6672 penalties are not assessed with respect to any return."¹¹² Therefore, it concluded that to the extent that there was something about 6672 that was "separate and distinct" from the employer liability it was "only for purposes of collection."¹¹³ Important for purposes of this article, the court held that "the assessment itself is based on the underlying liability of the employer."¹¹⁴

If the assessment is based on the underlying liability of the employer and is not a separate and distinct liability, then separating the two for purposes of assessing interest makes little sense. The logical point for

Maxim has paid its tax liability and related interest, the Internal Revenue Code provides no authority for charging plaintiffs with interest for the period during which Maxim was in bankruptcy. This argument mischaracterizes the legal basis for the assessments against plaintiffs. Strictly speaking, liability under section 6672(a) is not derived from, or dependent upon, an employer's outstanding tax obligation. Rather, the section imposes a penalty upon persons who fail to perform a specified statutory task. We have consistently held, therefore, that the liability for such a penalty is separate and distinct from the employer's liability for trust fund taxes." *Id.* at 710.

109. *Lauckner*, 1994 WL 837464 at *1. The similarities noted by the court between 6672 and 3403 parallel the similarities in the treatment of these liabilities in the bankruptcy code. These similarities form the basis for the government's policy decision in adopting Policy Statement 5-60, in which it states that the liability will only be collected once. The separateness discussed in *Bradley*, however, does seem more separate than the discussion in *Lauckner* addresses.

110. *Lauckner*, 1994 WL 837464. at *4.

111. *Id.* at *5.

112. *Id.*

113. *Id.*

114. *Id.*

imposing interest against the responsible officer is the same point when it arises with respect to the corporation since the liabilities are separate and distinct only for purposes of collection.¹¹⁵ The separateness for purposes of collection describes the separateness of the actual assessment. The IRS creates an assessment for each individual or entity liable for the 6672 liability and has a separate assessment for the person liable for the underlying tax which includes not only the collected taxes but also the employer portion of the liability as well.¹¹⁶

In an Action on Decision dated July, 15, 1996, the IRS acquiesced in the result in *Lauckner*.¹¹⁷ While the sudden change in the IRS position on the statute of limitations seemed to also influence the court's decision in *Lauckner*,¹¹⁸ the basis for its conclusion supports the policy behind the position that the 6672 liability should result in interest running with the employment tax liability to which it is so closely aligned. While the decision in *Lauckner* did not leave the IRS in any worse position than it was in before it realized that 6672 was an assessable penalty just like 6701, the picture now clearly presents 6672 as an assessable penalty with the worst of both worlds. It does not have the unlimited statute of limitations enjoyed by other assessable penalties since it is viewed as being tied to a return; however it does have the interest provisions of 6601(e), discussed *infra*, with other assessable penalties, denying the running of interest until the assessment occurs. This is an odd combination of handicaps to place on a liability protecting the funds held in trust for the United States and a liability so important that, unlike any other assessable penalty, Congress gives it not only priority status in bankruptcy but priority status for the life of the collection statute.

E. THE PROBLEM OF INTEREST

As alluded to above, the placement of 6672 in the assessable penalty

115. See the argument in Brief of Petitioner-Appellant at 25, *United States v. Sotelo*, 436 U.S. 268, (1978) (No. 76-1800). "Liability for taxes under Section 6672 is deemed 'due and owing' on the date the person responsible for seeing the taxes are paid failed to do so - the date the corporate returns were due to be filed."

116. The IRS made additional arguments in *Lauckner* based on the relevant return for purposes of I.R.C. § 6501(a) and Congressional intent. These arguments were also rejected with the reasoning that covers matters not related to this paper.

117. I.R.S. A.O.D. 1996-006, 1996-2 C.B. 1.

118. *Lauckner*, 1994 WL 837464 at *1. In the second paragraph of the opinion the court clearly expresses its concern that the IRS position reflected a reversal of its long held position concerning the applicable state of limitations. "It argues for perpetual exposure despite its long-standing position to the contrary, coupled with judicial acceptance and congressional acquiescence for more than 30 years. Such a radical change must come from the legislature and not the courts, particularly where it seeks to leave persons exposed to tax liability in perpetuity." *Id.*

provisions positions it for treatment with respect to interest that contradicts the purpose of 6672 and that creates a lack of parallel structure with similarly situated taxpayers. To understand how this works requires analyzing the interest provisions.

1. The Mechanics of the Interest Provisions in IRC 6601

Section 6601 sets out the rules, not the rates, for interest on liabilities imposed in Title 26. The rule for taxes found in 6601(a) provides that interest runs “from the last date prescribed for payment of the tax to the date on which payment is received.”¹¹⁹ The last date prescribed for payment of taxes generally coincides with the due date of the tax return for that tax without taking into account extensions of the date for filing.¹²⁰ For example, the due date for individual income taxes falls on the 15th day of the fourth month following the close of the tax year.¹²¹ That date, April 15, starts the running of interest for individual taxpayers for the calendar year that ended immediately prior to that April. If an individual remits payment for a income tax prior to April 15 either by withholding, estimated payments or payment with the return, then no interest accrues with respect to that year’s tax liability (unless a subsequent assessment occurs). If an individual does not remit sufficient funds by April 15 to cover the tax liability for the preceding year, then interest begins to run on April 16 and runs until full remittance reaches the IRS or the IRS abates the tax.

The general rule for interest on income taxes described above also applies to employment taxes. The employment tax return due date comes at the end of the month immediately following the end of the quarter, e.g., April 30th for the first quarter. If the employment taxes due for the first quarter remain unpaid as of the April 30th immediately following the end of the quarter then interest begins to run and continues running until paid.

The rule for interest on assessable penalties follows a different path. The Treasury Regulation interpreting I.R.C. 6601(e)(2) provides that “interest will not be imposed on any assessable penalty, . . . if the amount is paid within 21 calendar days . . . from the date of the notice and demand. If interest is imposed, it will be imposed only for the period from the date of the notice and demand to the date on which payment is received.”¹²² Notice and demand occurs simultaneously with or immediately following the assessment of a liability.¹²³ Since 6672 falls into the assessable penalty

119. Treas. Reg. § 301.6601-1(a) (as amended in 1997).

120. I.R.C. § 6151(a).

121. I.R.C. § 6072(a).

122. Treas. Reg. § 301.6601-1(f)(3) (as amended in 1997).

123. I.R.C. § 6303; Treas. Reg. § 301.6303-1 (as amended in 2001).

section of the Code, this provision and not the provision for taxes applies to the running of interest on assessments made pursuant to this statute. That difference appears to result solely from the placement of 6672 in the Code and no explanation for its placement with respect to interest exists in the legislative history of 6672 or 6601.

2. Problems Created by the Interest Provisions Applicable to 6672

Because of 6672's placement as an assessable penalty and the consequent application of IRC 6601(e) rather than IRC 6601(a), three problems exist with respect to the application of 6672. First, the delay in the running of interest against responsible officers treats similarly situated taxpayers in a disparate manner. This creates a fairness issue. Second, the treatment of interest for those liable pursuant to the derivative liability of 6672 works differently than the interest charged to those derivatively liable under similar statutes. This highlights a lack of a consistent approach with respect to parties held liable when the initial taxpayer did not fulfill its obligation. Third, the delay in the running of interest creates problems for the IRS. It loses the time value of money for the period between the return due date and the date of assessment of the responsible officer. This interest free period also harms the IRS because it creates an incentive for responsible officers to delay and burden the system of administration to gain the benefit of the time value of money. The postponement of interest also puts the federal government at odds with its state counterparts providing an incentive for responsible officers to satisfy their state obligations for unpaid collected taxes first.

a. *The disparate treatment of similarly situated taxpayers*

That the form of an entity or a transaction can control the outcome in a tax matter needs no citations. Nonetheless, in certain matters varying results based simply on form can create cries for fairness.¹²⁴ Section 6672 creates a lack of fairness with respect to the imposition of interest between those individuals who incorporate their business and those who do not. Changing the statute to charge persons liable under 6672 with interest back to the due date of the entity's return would eliminate that inequality.

The form of the entity definitely matters to the person who decides not

124. See Thomas E. Fritz, *Flowthrough Entities and the Self-Employment Tax: Is it Time for a Uniform Standard?*, 17 VA. TAX REV. 811 (1997-1998); Fred B. Brown, *Federal Income Taxation of US Branches of Foreign Corporations: Separate Entity or Separate Rules?*, 49 TAX L. REV. 133, (1993).

to pay over collected taxes. If the person has employed corporate form, then the collection against that individual will take place through 6672 with no interest accruing and no penalties until the point of assessment. If, however, the person does business as a sole proprietorship or a single member LLC treated as a disregarded entity, then that person is liable for interest on the unpaid employment taxes from the due date of the return.

Looking at the original example used in this article can provide some insight into this problem. Assume that Bob, Mary and John ran ABC as a partnership in which they were general partners rather than a corporation. If ABC fails to pay \$50,000 in withheld income taxes for the first quarter of 2008 over to the government by April 30, 2008, the due date of the employment tax return for the first quarter, interest will run from April 30, 2008. Each of them as general partners is liable for the full amount of the unpaid withheld income taxes (\$50,000) plus interest from April 30, 2008. If Bob ran ABC as a sole proprietorship instead he would also be liable for the full amount of the tax plus interest from April 30, 2008. If, however, ABC were incorporated, interest would not run against Bob, Mary and John as responsible officers until the 6672 was made against them. Assuming 5 percent simple interest and an assessment on April 30, 2010, two years after the return due date, the savings in interest would be approximately \$5,000.

Senator Ervin in his floor statements concerning the amendment of the Bankruptcy Act to include section 17a(1)(e) and the majority of the Supreme Court in *Sotelo* both expressed concerns about the equality of treatment persons liable for collected taxes who had incorporated versus those who ran their businesses as a sole proprietorship. The two parties addressed the subject from the perspective of the discharge in bankruptcy at issue in *Sotelo*; however, the reasoning could apply to the difference created with respect to the running of interest. The Court in *Sotelo* quoted Senator Ervin's statements made during the consideration of the amendment to the Bankruptcy Act of section 17a(1)(e) "The inequity between a corporate officer and an individual entrepreneur, both of whom have a similar liability to the government, frequently would turn on nothing more than whether the individual was 'sophisticated' enough 'to, in effect, incorporate himself.'"¹²⁵

Justice Marshall, writing for the majority in *Sotelo*, expressed similar concerns of fairness as a basis for the majority's decision. "The dissenting opinion recognizes Congress' unquestioned concern about eliminating corporations' 'unfair' advantage over individual entrepreneurs. Elsewhere our Brother Rehnquist appears to concede that Congress meant 'to

125. *United States v. Sotelo*, 436 U.S. 268, 281 (1978) (quoting 112 CONG. REC. 13809, 13817 (1966)).

ameliorate the lot' of only 'some bankrupts' when it passed the 1966 amendment to the Bankruptcy Act. There is every indication that the 1966 amendment was not intended 'to ameliorate the lot' of corporations and their principal officers, at least with regard to taxes collected from employees. And the dissenting opinion has not even attempted to explain how a Congress concerned about '[discrimination] against the private individual or the unincorporated small businessman,' could have thought it just to relieve corporate officers of § 6672 liability in bankruptcy, as the dissent's approach would do, while leaving other owners of 'small family [businesses],' those who happen to operate through non corporate entities—subject to the same kind of liability."¹²⁶

While slightly different in nature, the same type of disparity that concerned Senator Ervin and Justice Marshall still exists in the application of 6672 because of the manner in which interest and penalties are treated. Those who fail to incorporate and fail to pay collected taxes pay the higher price even though the policy for collecting the tax seems identical in both instances. This disparity prevents a parallel result between similarly situated taxpayers. This lack of parallelism does not promote effective tax administration and fails to achieve a sense of fairness desired in tax legislation.¹²⁷ The disparity also fosters the wrong incentive to promote prompt payment and compliance.¹²⁸

b. *The misalignment with similar statutes*

Section 6672 provides a mechanism for holding third parties liable for the payment of a tax for which a corporate entity has primary liability. The derivative nature of the liability imposed by 6672 creates an exception to

126. *Sotelo*, 436 U.S. at 281 n.16 (internal citations omitted).

127. Much has been written on the role of horizontal equity and parallelism in tax legislation. These concepts are important because taxpayer perceptions are important. Enforced compliance measures by the IRS cannot account for the level of compliance by the taxpaying public. Fairness in the system is critical. Jeffrey H. Kahn, *The Mirage of Equivalence and the Ethereal Principles of Parallelism and Horizontal Equity*, 57 HASTINGS L.J. 645 (2006). In this article, Professor Kahn devises a test to determine when parallel treatment of a specific tax circumstance is desirable and when countervailing considerations drive nonparallel treatment as the correct result. He did not test this situation. Using his tests a strong argument exists for parallel treatment with respect to interest between individuals who fail to pay over monies held in trust for the government. These individuals whether operating as a sole proprietorship, partnership, or in corporate form have already received parallel treatment—the very reason for piercing the corporate veil. No reason exists for departing from that parallel treatment in the imposition of interest. See also Dave Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43 (2006); Richard Winchester, *The Gap in the Tax Gap: What Congress Should Do About It* (June 25, 2008). Thomas Jefferson School of Law Legal Studies Research Paper No. 1151363, available at <http://ssrn.com/abstract=1151363> (addressing parallelism in employment tax issues).

128. Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1456 (2003).

the normal rule for liability but not a unique situation. Other statutes also create derivative tax liabilities for third parties not primarily liable for the tax. The executor provision of 31 U.S.C. 3713, the transferee liability provisions of 6901, and the lender liability provisions of 3505 each provide a parallel situation to 6672. These statutes offer another view regarding the accrual of interest against third parties. Of these three, 3505 deserves the most attention since it sprang from perceived inadequacies in 6672.

The so-called insolvency statute found in 31 U.S.C. 3713 applies to situations broader than just tax. Essentially, it holds someone like an executor personally liable for the payment of the taxes of an estate when the executor distributes assets to beneficiaries or pays out lower priority creditors without satisfying the taxes of the estate. The person liable under the insolvency statute must pay interest (and penalties) on their personal liability stemming from misapplication of estate assets to the extent that the value of the assets distributed exceeds the amount of the outstanding liability.¹²⁹

A transferee under 6901 also must pay interest depending on the value of the property transferred. The extent of the liability is the transferor's unpaid taxes (including interest and penalties) for the transfer year and prior years to the extent of the value of the assets plus interest.¹³⁰ Whether a transferee is liable to the full extent of the transferor generally depends on the value of the asset(s) transferred together with the amount of the liability at issue. Where the transferred assets exceed in value the amount of the liability, the transferee will generally be liable for interest and penalties on the transferor's taxes.¹³¹ If the transferred assets are less than the amount of the liability, the transferee's liability is generally capped at the value of the assets received with the possibility that under state law interest might accrue on the value of the assets received.¹³² If a notice of transferee liability is sent, the transferee is liable for interest on the amount assessed pursuant to that notice. The interest runs from the date of the notice of

129. See *United States v. Estate of Kime*, 950 F.Supp. 950, 954 (D. Neb. 1996) (finding the Insolvency Statute holds a representative of an estate liable for the unpaid tax liability, interest, and penalties of the estate); *United States v. Coppola*, 85 F.3d 1015, 1020-21 (2d Cir. 1996) (limiting the liability of the representative to the amount of the payment made or the value of the assets distributed before taxes are paid; importantly, the court found that the executor was liable for the unpaid taxes plus interest under 31 U.S.C. § 3713).

130. *Papineau v. Comm'r*, 28 T.C. 54, 58 (1957); *Yagoda v. Comm'r*, 39 T.C. 170, 186 (1962), *aff'd*, 331 F.2d 485, 492 (2d Cir. 1964), *cert. denied*, 379 U.S. 842 (1964). The cap on the liability described here applies to transferee cases "in equity." Generally, no cap exists for transferee cases "at law."

131. *Lowy v. Comm'r*, 35 T.C. 393, 394-95 (1960). For a general discussion on the issue of interest on transferee liability see Theodore D. Peyser, *Transferee Liability*, 628-2d TAX MGMT. (BNA) A-25-27 (2003); MICHAEL I. SALTZMAN, *IRS PRACTICE AND PROCEDURE*, 17-27-33 (Warren Gorham Lamont 1991) (1981).

132. *Stein v. Comm'r*, 37 T.C. 945, 961 (1962), *supp. op.*, 40 T.C. 275 (1963).

transferee liability.¹³³

Someone tagged with liability under the insolvency or the transferee statutes must pay interest back to the due date of the return of the person primarily liable. This general rule is tempered in some situations by the amount of assets the third party received *vis a vis* the amount of the total tax liability. If the value of assets in the estate or the value of assets transferred are below the amount of the primary liability, the liability of the third party is capped at the value of the assets. 6672 does not have a direct parallel to this provision limiting interest; however, the manner in which the taxpayer whose tax is collected receives full credit for that payment provides a basis for viewing the 6672 situation as one in which the corporation and the responsible officer received assets equal in value to the unpaid liability.¹³⁴ The policies leading to imposition of interest against these third parties support the imposition of interest back to the due date of the underlying return for those persons responsible under 6672.

The most significant of the three derivative liability provisions with respect to the treatment of interest is 3505 because it developed out of a loophole in 6672 and deals with a subset of the same liability that 6672 does.

In the 1950s and early 1960s, lending practices in the construction industry exposed a gap in the coverage of 6672 with respect to income and social security taxes withheld from employees of troubled businesses in that employment sector. In closing that gap, Congress created a new statute that specifically provides that the third party liable under the new statute has liability for the interest from the due date of the return of the party primarily liable for the unpaid tax. While the legislative history of the new statute does not provide any insight as to why the interest provision appears in this new statute (and not in 6672), the adoption of the interest provision in 3505 supports the imposition of interest for all collected tax situations.

Section 3505 was enacted as part of the Federal Tax Lien Act of 1966

133. *Patterson v. Sims*, 281 F.2d 577, 581 (5th Cir. 1960). The courts are split on the liability for accrued interest if the underlying tax is an estate or gift tax. *Compare* *Baptiste v. Comm'r*, 29 F.3d 433, 438 (8th Cir. 1994), *cert. denied*, 513 U.S. 1190 (1995) *with* *Baptiste v. Comm'r*, 29 F.3d 1533, 1535 (11th Cir. 1994).

134. *See e.g.*, I.R.C. § 31 (2008). Section 31(a) provides that "the amount withheld . . . shall be allowed to the recipient of the income as a credit against the tax imposed by this subtitle." This provision insures that a worker whose wages have been reduced by the amount of the withheld taxes will receive credit for payment of those taxes even if the company that withheld the taxes fails to pay them over to the government. This credit extends even to the taxes withheld on the wages of individuals determined to be responsible for failure to pay over the withheld taxes. As a consequence, the government, through this provision, grants full value for the withheld taxes whether it receives that value or not. This granting of full value provides an equivalent to the transferee who has received from the taxpayer material equal to or greater than the value of the taxes owed by the transferor.

at the request of the government to plug what it perceived to be a loophole in the collection of withheld employment taxes.¹³⁵ The specific loophole 3505 sought to address concerned third parties who paid, either directly or indirectly, the wages for an employer in such a manner that the withheld employment taxes did not get paid over to the government.¹³⁶ Section 3505 does not address all types of collected taxes discussed in footnote 5, *supra*. It imposes liability on lenders, sureties, and others who lend net payroll in a manner that causes a failure to pay over to the government withheld federal income tax, FICA tax and railroad retirement tax. The statute has two components: 3505(a) imposes liability for the full amount of the unpaid tax on third parties who pay net wages directly to the employees, and 3505(b) imposes a limited personal liability on third parties who provide the funds used to make net payroll payments of no more than 25 percent of the unpaid employment taxes.¹³⁷ As mentioned above, the collection problem

135. See H.R. REP. NO. 89-1884, (1966), *reprinted in* 1966-2 C.B. 815, 828-30; S.REP. NO. 89-1708, (1966), *reprinted in* 1966 U.S.C.C.A.N. 3722, 3724, 3742-45 (one of the statements provided in the legislative history here describes 3505 as "intended to represent a reasonable accommodation of the interests of the government in collecting the taxes of delinquent taxpayers with the rights of taxpayers and third parties."). One commentator states that "prior to 1966 no lender or other institutional creditor had ever been held liable for the § 6672 penalty." Larry A. Makel & James C. Chadwick, *Lender Liability for a Borrower's Unpaid Payroll Taxes*, 43 BUS. LAW. 507, 520 n.56 (1988).

136. The term for this practice, net payroll financing, does not appear in the statute but found common usage during the discussion of the need for this provision as described in *United States v. Algernon Blair, Inc.*, 441 F.2d 1379, 1381 (5th Cir. 1971):

Prior to the effective date of § 3505(b), problems arose with the construction industry's device known as 'net payroll financing.' Using this method, a sub-contractor-employer, who had financially overextended himself would go to a lender, in this case the prime contractor, for financial assistance. The prime contractor-lender, desirous of having the sub-contractor complete the work, but also wanting to minimize costs would provide only the net payroll funds. In many of these situations, the United States would never receive the withholding taxes due, even though the employees received credit on the records of the Treasury Department as if the taxes had been paid. While the sub-contractor-employer would still be liable for the taxes under §§ 3102(b) and 3404 of the Code, recourse against the employer was often fruitless, as he was financially unable to pay the taxes.

137. I.R.C. § 3505 (2008) provides:

(a) Direct payment by third parties. For purposes of sections 3102, 3202, 3402 and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (*together with interest*) required to be deducted and withheld from such wages by such employer.

(b) Personal liability where funds are supplied. If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum

the IRS primarily sought to address through this legislation involved the construction industry.¹³⁸

Prior to the enactment of 3505, the IRS lost several cases in which it attempted to assert the 6672 penalty against the type of third parties described in 3505.¹³⁹ Courts determined that such individuals were willful but not responsible. At the same time, the alleged responsible persons would win their cases under 6672 because they were responsible but not willful. These responsible persons would testify, usually quite correctly, that the lender would not permit them to pay the employment taxes even though they had tried to do so. Section 3505 filled the gap caused by the circumstances of the lender who essentially controlled the finances of a cash-poor entity but whose role did not neatly fit the statutory scheme of 6672.

Two common situations occurred that posed problems for the IRS in attaching the 6672 penalty where employment taxes were not paid. The first, and perhaps most common, scenario involved companies with cash flow problems. These companies would negotiate a line of credit with a bank. As business worsened the bank's involvement increased. At some point in the relationship, a loan officer at the bank essentially took over the duty of approving every check written by the company. The loan officer then made decisions to pay employees their wages but also refused to allow

equal to the taxes (*together with interest*) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

(c) Effect of payment. Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer." (emphasis added).

138. "As of January, 1965, the delinquent accounts in the construction industry totaled \$55,608,622.00, which was twenty-six percent of all delinquencies of this type of taxes. As of the same date, \$29,730,508.00 of the \$55,608,622.00, or fifty-three percent, had been overdue for more than one year. And according to the same Treasury figures, it had written off in 1964, as uncollectible from the construction industry, the sum of \$16,290,098.00, which was twenty-eight percent of all unpaid withholding taxes for all industries written off during that year." Edward Gallagher, *The Good and the Bad for Surety Companies Under the Federal Tax Lien Act of 1966*, 34 INS. COUNS. J. 214, 218 (1967).

139. *United States v. Hill*, 368 F.2d 617, 623 (5th Cir. 1966) ("[T]he bank agreed to loan to the corporation funds to complete jobs in progress. The only control which the bank exercised during this period was in connection with the funds which it loaned. Taxpayer Hill admitted at trial that he understood the bank's refusal to honor checks for taxes drawn on these funds to be merely a statement that the bank would not loan the corporation funds for the taxes. Certainly this refusal to make a loan did not place the bank in control of the corporation's checking account or alter appellants' control of the corporation."); *GirardTrust Corn Exchange Bank v. United States*, 259 F.Supp. 214, 216-17 (E.D. Pa. 1966); *United States v. Park Cities Bank & Trust Co.*, 481 F.2d 738, 741 (5th Cir. 1973); *United States v. Algernon Blair, Inc.*, 441 F.2d 1379, 1382 (5th Cir. 1979); *United States v. Coconut Grove Bank*, 545 F.2d 502, 506 n.2 (5th Cir. 1977) (lists the cases). Many of the cases cited in this footnote and listed in *Coconut Grove Bank* include additional arguments by the United States in its attempts to hold the third party lenders liable. Seeking to hold the lender liable under a contract theory and seeking to hold it liable as the "true" employer were the primary additional theories. Those arguments are not important to the purpose of this article.

the company to write the employment tax check to the IRS. The company would eventually fail and the IRS would come looking for the employment taxes.

The second variation on this theme usually occurred in the construction industry.¹⁴⁰ A general contractor would hire a subcontractor to complete a specific task on a larger job. The subcontractor would encounter financial difficulty. The general contractor needed the subcontractor to complete the task for which it had been hired or the entire project would fall behind with all of the attendant consequences. The employees of the subcontractor who were not getting paid would refuse to work without pay. So, the general contractor or its surety would step into the breach and pay the net wages of the employees of the subcontractor. At some point the subcontractor would fail before the employment taxes were paid.

As mentioned above, 3505 has two components which attempt to address problems presented by both direct payment of net payroll by a third party and indirect payment of net payroll. Section 3505(a) holds a person liable in an amount equal to the entire amount of the payroll taxes required to be withheld and paid over in those situations in which the third party directly pays the wages of the employees of the company that fails to pay its employment taxes. The 3505(a) liability arises upon the payment of the wages whether or not the third party knows taxes should be paid or withheld.¹⁴¹

Section 3505(a) prevents third parties from taking over a company's payroll and paying net wages. The third party becomes liable not only for taxes on the wages from the date the wages are paid but the third party is liable also for interest back to the due date of the return. Imposing liability on a third party in this situation was viewed as "fair" because the third party knows the finances of the employer.¹⁴²

The liability under 3505(a) is not imposed by way of assessment as with 6672. In order to hold a third party liable under 3505 the government must bring a suit against the third party. The statute of limitations for the

140. See *Algernon Blair, Inc.*, 441 F.2d 1379 (5th Cir. 1971).

141. *Abrams v. United States*, 333 F. Supp. 1134, 1147 (S.D. W. Va. 1971). A later court set up a two part test that must be satisfied in order for a payment to be considered a direct payment of wages under 3505(a). First, the payor must have the ability to control the funds. If the employer controls the funds then the situation would shift from 3505(a) to some other provision such as 3505(b) or 6672. Second, the payor must have the right and legal authority to exercise that control. *United States v. Fred A. Arnold, Inc.*, 573 F.2d 605, 608 (9th Cir. 1978); see also *United States v. Kennedy Construction Co. of NSB*, 572 F.2d 492, 496 (5th Cir. 1978); *Derr v. United States*, 498 F. Supp. 337, 340 (W.D. Wis. 1980).

142. H.R. REP. NO. 89-1884, (1966), reprinted in 1966-2 C.B. 815, 829; S. REP. NO. 89-1708, (1966), reprinted in 1966 U.S.C.C.A.N. 3722, 3743.

suit is the statute of limitations on collection of the underlying liability.¹⁴³ The government bears the burden of proof in the litigation to show that the third party directly made net payroll payments to the employer.

The existence of 3505(a) has undoubtedly caused lenders to change their practices to avoid this pitfall.¹⁴⁴ Very few 3505(a) cases exist.¹⁴⁵ A lender directly paying net payroll has little room to hide. This provision serves an important role in prevention but receives little enforcement attention because of the straightforward and predictable outcomes it creates.

Section 3505(b) does not impose the broad liability set out in subparagraph (a). Nor does 3505(b) involve the relatively easy to identify direct payment of net wages. Instead, 3505(b) concerns the actions of those who provide funds to the employer knowing that the funds will be used to meet payroll and that the employment taxes will not be paid.

As with 3505(a) the liability under subsection (b) does not occur through an administrative assessment but rather the government must bring a suit to establish the liability. The government has the burden of proof in the suit. The liability under 3505(b) has a limitation of 25 percent of the amounts paid to the employer for the purpose of making net wage payments. The statute provides for interest back to the due date of the return; however, case law has limited the amount of interest recoverable by treating it as a part of the 25 percent cap and not an addition to that amount.¹⁴⁶

143. Treas. Reg. § 31.3505-1(d) (as amended in 1995) provides: "In the event the lender, surety, or other person does not satisfy the liability imposed by Section 3505, the United States may collect the liability by appropriate civil proceedings commenced within 10 years after assessment of the tax against the employer."

144. In fact Congress anticipated that lenders would take certain precautions to avoid the liability under this statute. "[S]ureties can protect themselves against any losses attributable to withholding taxes by including this risk of liability in establishing their premiums, and lenders by including the amounts in their loans and taking adequate security." *Jersey Shore State Bank v. United States*, 479 U.S. 442, 449 (1987), (citing S. Rep. No. 89-1708, reprinted in 1966 U.S.C.C.A.N. 3722, 3744 and H.R. Rep. 89-1884, reprinted in 1966-2 C.B. 815, 830).

145. See Julius Thannhauser et al., *Lender's Liability for Unpaid Withholding Taxes of Borrower—Employer—IRC Sections 3505 and 6672*, 80 COM. L. J. 137 (1975); See also Mark R. Hinkston, *Dealing with the Disarray: The Eighth Circuit Addresses Notice and Demand Applicability to Lenders' Liability For Withholding Taxes Under I.R.C. 3505(b)—United States v. Messina Builders and Contractors Co.*, 20 CREIGHTON L. REV. 1093, 1099 n.26 (1987) (this article has an excellent introductory section on the legislative history of 3505).

146. The IRS took the position initially that interest due from the third party under 3505(b) added onto the 25 percent. Treas. Reg. § 31.3505-1(b) (as amended in 1995); Rev. Proc. 78-13, 1978-1 C.B. 591. It lost this issue in three circuits. See *United States v. Metro Constr. Co.*, 602 F.2d 879, 882 (9th Cir. 1979); *United States v. Intercontinental Industr., Inc.*, 635 F.2d 1215, 1222 (6th Cir. 1980); *United States v. Hannan Co.*, 639 F.2d 284, 285 (5th Cir. 1981). After these losses, the IRS abandoned the position that the person liable under 3505(b) must pay interest in addition to the 25 percent of net payroll. See I.R.S. Litigation Guideline Mem. GL-14 (May 4, 1994).

A lender has knowledge for purposes of 3505(b) from (1) the time the lender receives notice of this fact¹⁴⁷ or (2) the time the lender would have known if exercising due diligence.¹⁴⁸ Because the liability under 3505(b) requires the government to show this knowledge, the government can experience difficulty establishing this liability. The government does not need to prove, however, that a formal loan agreement existed. Honoring overdrafts over a period of time can also trigger this liability.¹⁴⁹

An exception to 3505(b) liability for lending for net payroll occurs for working capital loans. Perhaps the exception need not have been explicitly stated in the statute because of the knowledge provision of the statute, nonetheless it exists as a stated exception. Lenders must take care when making working capital loans if they learn that the loans finance net payroll.¹⁵⁰ Likewise, lenders pursuing remedies upon default of a loan do not enter 3505(b) territory unless they become too entwined in the business of the distressed entity.¹⁵¹

Because the liability under 3505 is not considered a tax liability, the interest component referred to in the statutes does not represent interest on the employment taxes themselves.¹⁵² The liability of the lender is for a sum equal to the unpaid trust fund portion of the employment taxes rather than the taxes due from the employer.¹⁵³ Depending on the type of 3505 liability, the third party may have no interest liability because of the interpretation of the 25 percent cap in 3505(b). Nonetheless, the statute does contemplate in general that the third party engaged in the actions described by 3505 is liable for interest on the delinquent employment taxes. Two examples demonstrate how the interest component of 3505 works:

147. Once the fact that funds are being used for net payroll is brought to the attention of the lender, the lender is deemed to meet the knowledge part of this test. *United States v. Park Cities Bank & Trust Co.*, 481 F.2d 738, 740 (5th Cir. 1973); *United States v. Estate of Swan*, 441 F.2d 1082, 1087 (5th Cir. 1971).

148. The statute references section 6323(i)(1), which provides that: "An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routine. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information." I.R.C. § 6323(i) (2000).

149. *United States v. First Nat'l Bank of Circle*, 652 F.2d 882, 889 (9th Cir. 1981).

150. *United States v. Intercontinental Industr.*, 635 F.2d 1215, 1218-19 (6th Cir. 1980); *Fidelity Bank, N.A. v. United States*, 616 F.2d 1181, 1184-85 (10th Cir. 1980).

151. *Werner v. United States*, 374 F. Supp. 558, 563 (D. Conn. 1974), *aff'd*, 512 F.2d 1381 (2d Cir. 1975).

152. See *Jersey Shore State Bank v. United States*, 479 U.S. 442, 446 (1987) ("Section 3505 does not declare that a lender is 'liable for the unpaid tax.' Instead, the section imposes liability on the lender for all or part of 'a sum equal to the taxes.'").

153. *Id.* at 446-47 (holding that because the 3505 liability was not a tax but rather a judgment for a sum certain based on the tax, the IRS was not required to follow all of the notice provisions set out in the Internal Revenue Code for collection of taxes). Specifically, I.R.C. § 6303, requiring notice and demand prior to collection, did not apply to this situation.

Example 1: ABC Inc. experiences financial difficulty during 2007 and XYZ Bank becomes increasingly involved in its finances. It looks like ABC might get a contract that will pull it out of the tailspin but it is totally out of gas pending the award of that contract. It must keep the business going, however, to remain competitive. During the first quarter of 2008 XYZ Bank directly pays the payroll of ABC. Neither the bank nor the company pays the withholding taxes of \$25 over to the IRS. ABC dissolves without making any payments on the employment tax liability for the first quarter of 2008. The IRS cannot pursue Bob, Mary and John because XYZ bank had assumed financial control of ABC making Bob, Mary and John either not responsible or not willful or both. The IRS pursues XYZ pursuant to 3505(a) and obtains a judgment for \$25 for the full amount of the unpaid withholding taxes plus interest from April 30, 2008, the due date of the employment tax return.

Example 2: ABC Inc. experiences financial difficulty in 2007 and XYZ Bank becomes increasingly involved as in Example 1. During the first quarter of 2008 XYZ lends to ABC \$80 so that ABC can pay net payroll. XYZ knows the finances of ABC and knows that ABC does not have sufficient funds to pay over the withholding taxes. ABC dissolves without making any payment on the employment tax liability for the first quarter of 2008. The withholding tax obligation of ABC for the first quarter of 2008 is \$25. Again, the IRS would probably fail if it pursued a 6672 liability against Bob, Mary or John. The IRS pursues XYZ pursuant to 3505(b) and obtains a judgment for \$20 equal to 25 percent of the net payroll lending. The IRS cannot obtain interest on this amount because it is limited to a 25 percent recovery.¹⁵⁴

One case that highlights the differences between 6672 and 3505 and explores the reach of the term “responsible person” in 6672 is *Pacific National Insurance, Co., v. United States*.¹⁵⁵ Pacific National, a surety, loaned money to Central States Construction and Equipment Company (Central) from May to September, 1955. This time period predated the enactment of 3505 even though the 9th Circuit’s opinion followed the passage. Because of the period in issue, the IRS had to argue for the assessment against Pacific National under 6672. Naturally, Pacific National argued that 3505 applied to its circumstances, albeit not literally since it did not exist in 1955, and 6672 did not reach the situation presented by this case.

154. See I.R.C. § 3505, *supra* note 137.

155. *Pacific Nat. Ins. Co. v. U.S.*, 422 F.2d 26, 27, 30-33 (9th Cir. 1970).

The court examined the legislative history and found little aid in determining the scope of persons who were included. It determined that Pacific National met the language of responsible person set forth in 6672 and sustained the decision of the District court holding Pacific National liable for taxes under 6672. The case points out that 3505 and 6672 overlap. In fact, the government recommends looking to hold parties liable under both provisions when possible.¹⁵⁶ The result in *Pacific National*, displaying the overlap between 3505 and 6672 on collected employment taxes, points out the possibility that the government could obtain interest from a responsible party back to the due date of the return by pursuing one statute, 3505, while a parallel result remains unavailable if it pursues the responsible officer under 6672.¹⁵⁷

Did Congress intend to provide interest on collected taxes back to the due date of the return only for that narrow class of collected taxes represented by “net lenders” of wages? Does this class of responsible officers have some special responsibility not borne by all others who convert funds held in trust to some other purpose? Since 3505 updates 6672 and closes a narrow loophole on one aspect, could Congress have included interest in 3505 without realizing that interest back to the due date of the return did not apply in other responsible officer situations? Answers to these questions do not exist in the legislative history of 3505. One possible answer, that Congress simply did not think about the lack of symmetry on the interest issue between the two statutes imposing liability on responsible persons, provides support for seeking symmetry now to close the gap between the two statutes. While 3505 came into existence to close one loophole in 6672, Congress inadvertently exposed a fundamental flaw in 6672. The fixing of that flaw requires imposing interest on the responsible officers back to the due date of the return.

c. *The problems created for the IRS*

The first problem that the failure to charge interest under 6672 creates for the IRS is the loss of the time value of money. As the example with ABC shows, the amount of interest that runs between the time the employment tax return is due and an assessment occurs with respect to one

156. “Thus, in considering the application of section 3505, the possibility of also asserting the trust fund recovery penalty against the lender or an employee of the lender should not be overlooked.” I.R.S. Litigation Guideline Mem. GL-14 (May 4, 1994).

157. See also *Commonwealth Nat’l Bank of Dallas v. United States*, 665 F.2d 743 (5th Cir. 1982); *Regan & Co. v. United States*, 290 F. Supp. 470, 479 (E.D.N.Y. 1968) (“[C]ongress sought to plug the loopholes against the limitless ingenuity of those whose métier it is to search for crevices between mortise and tenon in the infinitely complex definition and imposition of obligations in the Revenue Code.”).

or more responsible officers can be significant. When that example multiples across a system, the lost revenue begins to mount. Of course, the IRS will not collect all of the interest that runs on its 6672 assessments but it certainly would collect some of the money were it allowed to charge interest back to the due date of the return.

The second problem for the IRS concerns resources. Many of the individuals identified by the IRS as responsible officers subject to the 6672 liability know that they satisfy the statutory tests for liability under 6672. These individuals, who know they are liable, can agree to that liability at the first moment the IRS revenue officer appears seeking to investigate the liability; however, they have no incentive to do so. The minute they agree to the liability, an assessment will occur and interest will start to run. Consequently, the system provides an incentive for even the individuals who know they owe to exhaust their administrative remedies.¹⁵⁸ This places a burden on IRS resources that might significantly diminish if liable individuals lost their incentive to delay.

The third problem created for the IRS results from the approach that most states have taken with respect to individuals liable for collected taxes not paid by the corporation that had primary responsibility. The significant majority of states have adopted an approach similar to the one suggested for the federal government in this article. These states hit individual responsible officers with the same liability, including interest and penalties, that are due from the corporation. They do not build in a period of delay for interest and penalties. Consequently, knowledgeable individuals faced with responsible officer liability to both the state and the federal government, which is often the case, will pay their money first to the states to stop the running of further penalties and interest while they continue to exhaust their administrative remedies with the IRS. This situation obviously puts the federal government at a competitive disadvantage in seeking to collect from these individuals.

158. "Section 6672 does not refer to any liability of a responsible person for interest on the delinquent taxes. A responsible person has no liability for interest on the unpaid withholding taxes to the extent that it accrues between the date that the employee's tax should have been paid and the date the IRS assesses the tax against the responsible person. *Hence, a potentially responsible person has reason to pursue all good faith defenses through the administrative process.*" JOHN W. SCHMEHL & RICHARD L. FOX, *Responsible Person and Lender Liability for Trust Fund Taxes* - §§ 6672 and 3505, 639-2d TAX MGMT. (BNA) A-45 (2000) (emphasis added); see also DAVID M. RICHARDSON, JEROME BORISON & STEVE JOHNSON, *CIVIL TAX PROCEDURE* 400 (LexisNexis 2d ed. 2008) (2005). "*An important advantage to protesting the penalty before it is assessed is that doing so stays the assessment of the penalty; consequently, interest does not begin to accrue.*" DAVID M. RICHARDSON, JEROME BORISON & STEVE JOHNSON, *CIVIL TAX PROCEDURE TEACHER'S MANUAL* 284 (LexisNexis 2007) (emphasis added). As seen below in the section discussing state laws on this issue, the administration of this issue by the IRS will also prove more difficult in most states if the taxpayer or the taxpayer's representative is well informed since the first payments will go to the state to stop the running of interest and penalties there rather than to the IRS.

All states with the exception of Wyoming have responsible officer statutes that work with many similarities to section 6672. Most state statutes draw directly from 6672 and, even if indirectly, certainly draw from the same policy framework that drove the creation of 6672. Despite their similar origins, the overwhelming majority of states have specifically written into their responsible officer statutes or have judicially interpreted their statutes in such a manner that their responsible officers are charged interest from the due date of the underlying return (and penalties as well). The manner in which the states have chosen to treat interest with respect to individuals responsible for paying over collected taxes supports the recommendation of this article.

While not controlling, viewing the manner in which states treat their delinquent trust fund obligations *vis a vis* responsible officers provides some insight from which the federal government can draw. As discussed previously, IRC 6672 covers a variety of taxes.¹⁵⁹ Employment taxes offer the best known example of trust fund taxes in the federal system under IRC 6672 but the excise tax on telephone service which is collected by the phone company on behalf of the federal government actually touches more people.¹⁶⁰ Because the number of telephone companies is relatively small and they typically do not have financial difficulties at the same rate as “regular” businesses, this particular trust fund tax has received little attention. The excise tax on telephone service, like the one on airplane tickets¹⁶¹ and motor fuel,¹⁶² behaves much like a sales or use tax common in state taxing schemes.¹⁶³ So, in looking at states for comparative purposes, both state withholding and sales tax provisions must be analyzed.

Because some states have no income tax¹⁶⁴ and some states have no

159. See *The Private Tax Collector*, *supra* note 5.

160. I.R.C. § 4251. In 2006, total collections for the telephone excise tax equaled 4.6 million dollars. I.R.S. SOI Bulletin Historical Table 20, Federal Excise Taxes Reported to or Collected by the Internal Revenue Service, Alcohol and Tobacco Tax and Trade Bureau, and Customs Service, by Type of Excise Tax.

161. I.R.C. § 4261.

162. I.R.C. § 4081.

163. These three federal excise taxes operate to charge the consumer of the item (telephone service, plane tickets or motor fuel) with a federal tax. The tax is collected by the provider of the service or item purchased. The tax is held in trust by the provider for the federal government. Similarly, a state sales tax imposes a liability on a purchaser of goods or other taxable items. The purchaser pays the tax at the time of the purchase of the goods. The vendor receives the payment for the tax and holds that payment in trust for the state which requires payment to it at certain intervals. One major difference between the federal excise taxes and the state sales taxes is the breadth of business impacted by these taxes. The federal excise taxes fall upon a relatively small number of business entities in very specific businesses. The state sales taxes fall upon almost every retailer and the state use taxes fall upon many other types of business providing a service. The numbers of the businesses being charged with preservation of trust funds by the states makes its scope much more like the federal withholding taxes and gives rise to a larger body of law concerning the failure to pay over sales taxes than exists with the failure to pay over federal excise taxes.

164. E.g., Texas, Washington, Florida, Alaska, South Dakota, Nevada, and Wyoming. Also, New

sales tax,¹⁶⁵ there exists at times only one type of tax for comparison within a specific state. Surprisingly, some states with both sales and income taxes treat failures with respect to the payment of each of these taxes differently when imposing the liabilities on individuals responsible for the trust fund taxes.¹⁶⁶ Those differences merit further exploration because within those states exists two models for trust fund treatment.¹⁶⁷

The vast majority of states with trust fund tax regimes¹⁶⁸ choose to impose upon the individual trustees (responsible officers) the precise liability imposed upon the entity that failed to meet its trust fund obligation.¹⁶⁹ Stated another way, these states have adopted, with respect to interest, the same result advocated herein. These states also uniformly impose penalties on unpaid trust fund taxes against the responsible officers going back to the due date of the entity's return.¹⁷⁰ The combination of imposing the penalty and interest due from the entity against the responsible persons creates a significant additional liability against these individuals compared to the liability imposed using the current federal regime under IRC 6672.¹⁷¹ This additional liability for interest and penalty charged to the responsible officer could, if collected, reduce the tax gap;¹⁷²

Hampshire and Tennessee limit income taxation to interest and dividends. *See infra*, Appendix A.

165. E.g., Oregon, Alaska, Delaware, and New Hampshire. *See infra*, Appendix A.

166. E.g., Idaho, New York and West Virginia; possibly also South Carolina. *See infra*, Appendix A.

167. *See discussion supra* p. 138.

168. All states except Wyoming have some form of trust fund regime imposing personal liability on person who fail to pay over to the state the taxes collected on its behalf.

169. *See infra*, Appendix A.

170. *Id.*

171. This is best illustrated through an example. Suppose that John Smith is the responsible officer of Acme, Inc. a Pennsylvania corporation which failed to pay over the income taxes it withheld for the first quarter of 2005 in the amount of \$50,000. If we assume that the IRS takes 12 months after the due date of the Form 941 on April 30, 2005, to initiate its trust fund recovery investigation and further assume that John Smith avails himself of the full range of administrative remedies prior to assessment while responding to the IRS at a very deliberate speed, it may be two years (April 30, 2007) after the due date of the return before the IRS assesses the trust fund recovery penalty against him. Assuming John failed to pay over collected taxes to Pennsylvania of the same amount for the same period, on April 30, 2007, John Smith will owe the IRS \$50,000 and on that same date he will owe the Pennsylvania \$61,000 consisting of \$50,000 in trust fund taxes, \$5,000 in interest and \$6,000 in penalties. Moving forward from April 30, 2007, John will owe interest and failure to pay penalties on both the federal and state liabilities; however, the interest will be on the higher amount of the Pennsylvania liability causing him to accrue even more interest (and penalty) expenses compared with his federal tax liability. *See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-617, TAX COMPLIANCE: BUSINESSES OWE BILLIONS IN FEDERAL PAYROLL TAXES, 32-33 (2008)* (stating that "from the time the tax debt was assessed against the business, IRS took over two years, on average, to assess [a 6672 liability] against the business owners/officers").

172. This is money that the federal government chooses not to seek even though the parallel state statute seeks it for the most states. The fact that most states are seeking to pick up this money does not compel the result that the federal government should do likewise; however, in a time of looking about for tax gap provisions, the practice of the overwhelming majority of the states on this issue should at least provide some food for thought for those writing the federal statutes with an eye toward more revenue. Another consideration for imposing the tax could be whether this class of individuals is one

however, the stronger reason for imposing interest, as argued herein, is the removal of the incentive to delay the assessment.¹⁷³

Some states explicitly provide for interest in the flush language of their statutes creating responsibility.¹⁷⁴ Other states have reached the same result by judicial decision.¹⁷⁵ States reaching the result by judicial decision with the courts referencing the fact that the responsible officer liability is an alternative means of collecting the trust fund tax is yet another model.¹⁷⁶ Based upon that reason for the liability of the responsible officer, the courts conclude the officer is liable for everything for which the entity is liable.¹⁷⁷

A minority of states treat interest in the same manner as the federal government.¹⁷⁸ These states have adopted statutes imposing the responsible officer liability that essentially mirror the language of I.R.C. 6672.¹⁷⁹ In interpreting their statutes, these states follow the federal

deserving of a break on interest or whether it is perhaps a class most deserving of making the government whole on the time value of the revenue lost through their actions.

173. This also poses room for thought when comparing the state and federal provisions. If most states impose interest from the due date of the entity return and the federal government imposes interest only upon assessment of the responsible officer liability, what rational taxpayer would pay the federal government first? In addition to the general incentive provided by I.R.C. 6672 to delay the assessment, the juxtaposition of the state and federal statutes causes the responsible officer aware of the manner in which the two statutes operate to use his first funds to pay down the state liability and stop the running of interest. By the time the federal government comes into the mix, the available funds from the responsible officer, which are generally not great to begin with, are further depleted, leaving the federal government to scramble harder to collect its trust fund liabilities once they are finally assessed.

174. Alaska, California, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, North Dakota, Oklahoma, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Washington, Washington D.C., Wisconsin. *See infra*, Appendix A.

175. Alabama, Kentucky, Maryland, Massachusetts, Michigan, New Mexico, North Carolina, Ohio, Rhode Island, Vermont, Virginia. *See infra*, Appendix A.

176. *Garland v. Director of Revenue*, 961 S.W. 2d 824 (Mo. 1998).

177. *Id.*

178. Three states do not charge interest back to the due date of the corporate return and follow the Federal model:

Arizona – ARIZ. REV. STAT. ANN. § 42-5028 (2006) (sales tax); ARIZ. REV. STAT. ANN. § 43-435 (2006) (withholding tax); *Arizona Dep't of Revenue v. Action Marine*, 181 P.3d 188 (Ariz. 2008); Telephone Interview with Renee Jordan-Essig, Arizona Department of Revenue, in Phoenix, Arizona (September 30, 2008); *In re Inselman*, 334 B.R. 267 (Bankr. D. Ariz. 2005);

Arkansas – ARK. CODE ANN. § 26-18-501 (1997); E-mail from John Theis, Assistant Revenue Commissioner, Arkansas Department of Finance and Administration to T. Keith Fogg, Visiting Associate Professor of Law, Villanova University School of Law (Aug. 15, 2008, 5:18 EST);

Delaware – DEL. CODE ANN. tit. 30, § 535(e) (1997) (withholding); (no sales tax in Delaware); E-mail from Randy R. Weller, Manager Bankruptcy/Decedents, Delaware Division of Revenue, to T. Keith Fogg, Visiting Associate Professor of Law, Villanova University School of Law (Mar. 10, 2008, 8:32:50 EST);

Utah – UTAH CODE ANN. § 59-1-302 (2007) (withholding and sales); Telephone Interview with Gale Francis, Assistant Attorney General, Utah Attorney General's Office, in Salt Lake City, Utah, Utah (March 14, 2008).

179. *Id.*

interpretation and do not impose liability until the assessment against the responsible officer occurs.¹⁸⁰

A still smaller minority of states chooses to impose a larger liability against the individuals liable for the trust fund liability than simply the amount of the unpaid trust fund taxes.¹⁸¹ These states impose the liability by means of a penalty. In Colorado the trust fund penalty is 150 percent of the collected tax.¹⁸² In Florida the trust fund penalty is 200 percent of the collected tax.¹⁸³ Penalties at these levels cause the responsible officer to have a liability that reflects something close to the liability imposed by those states hitting the taxpayer with the interest and penalty imposed on the entity. By adopting a scheme that imposes a penalty for late payment of collected taxes rather than one which simply seeks to collect the unpaid tax, plus interest, these states are at a disadvantage in bankruptcy proceedings.¹⁸⁴

The state provisions for treating interest on the liability for collected taxes imposed upon responsible officers provide an interesting window from which to view the federal statutes. Most states impose liability upon individuals because they build on the federal model. Yet, almost all states go past the federal model to cause their statutes to work in a manner that, with respect to interest, is philosophically consistent with the underlying reason for the statute.¹⁸⁵ The most interesting states are the states that "split the baby."¹⁸⁶ These states charge responsible officers with interest back to the due date of the entity's liability for sales taxes but charge interest only from the assessment date of the responsible officer's liability for unpaid withholding taxes. This division in approach, adopted by a small but

180. *Id.*

181. Two states do not charge interest back to the due date of the corporate return; however, they charge the responsible officer with a "penalty" equal to 150 percent or 200 percent of the unpaid trust fund taxes:

Colorado – COLO. REV. STAT. ANN. § 39-21-116.5 (West 2007) (sales and withholding) (150 percent); and

Florida – FLA. STAT. ANN. § 213.29 (West 2005) (sales); (Florida does not have an income tax).

182. COLO. REV. STAT. ANN. § 39-21-116.5 (West 2007).

183. FLA. STAT. ANN. § 213.29 (West 2005).

184. The scheme used by Florida and Colorado appears to transform the liability from a collected tax which would have priority under B.C. 507(a)(8)(C) to a general unsecured claim for a penalty.

185. Although not a part of this survey, liability for paying over collected taxes exists at the local level as well. One locality imposing liability for failure to pay over withholding taxes is Columbus, Ohio. Columbus charges the responsible officer with interest and penalty due from the entity that incurred the tax. "The officer or the employee having control or supervision of or charged with the responsibility of filing the report and making payment is personally liable for failure to file the report or pay the tax due as required by this section. The dissolution of a corporation does not discharge an officer's or employee's liability for a prior failure of the corporation to file returns or pay tax due." *Columbus v. Mid-Ohio Canopies*, No. 95APG06-685, 1995 Ohio App. LEXIS 4964 (Ohio Ct. App. 1995) (unpublished opinion).

186. Idaho, New York, West Virginia and South Carolina. *See infra*, Appendix A.

diverse set of states, suggests a statutory scheme built upon placement rather than consistent philosophy similar to the federal model. These states all have different language in different sections of their codes for dealing with persons responsible for collecting sales taxes versus persons responsible for withholding employment taxes. In both circumstances the money is to be collected and held by the employer for the state yet the code sections, adopted at different times for the different specific purposes, fail to take into account the essentially identical trust fund situation created in each situation.

The fact that the overwhelming majority of states choose to impose interest on responsible officers from the due date of the return of the entity suggests that the states see the direct link between the liability of the responsible officers and the liability of the entity. The state statutes reaching this result contain diverse language. The position adopted by a majority of the states has happened without the apparent benefit of any model other than 6672 itself. The laws adopted by the majority of the states represent a significant expression of how the derivative liability imposed upon responsible officers should be structured with respect to interest and validates the legal reasons expressed herein for modifying the federal statute.

IV. CONCLUSION

“Employment taxes represent the largest portion of total tax dollars collected by the IRS. In Fiscal Year 2007, for example, of the \$2.7 trillion in taxes collected by the IRS, \$1.7 trillion was payroll taxes.”¹⁸⁷ With this amount of money at stake, the importance of ensuring that third parties turn over the money collected for the federal government has critical budget implications. Section 6672 serves the current system for insuring collection from these third parties by imposing personal liability on the individual responsible for failing to pay over the taxes collected from third parties. As presently structured 6672 fails to fully carry out its purpose as a collection device to insure payment of these collected taxes. Fixing 6672 to impose interest on responsible officers back to the due date of the corporate return would align the operation of the statute with its purpose and would foster higher compliance with this provision that assists in collecting taxes in the most important segment of the federal tax system.

187. Linda Stiff, IRS Deputy Commissioner Services and Enforcement's, written testimony at the Senate Homeland Security and Government Affairs Permanent Subcommittee on Investigations on the Collection of Federal Employment Taxes, 2008 ARD 147-5 (CCH) (July 30, 2008).

Appendix A – States Imposing Interest on Responsible Officers From Due Date of Return

Alabama – ALA. CODE §§ 40-29-72, 73 (1998); *McPhillips v. State*, No. P-04-377, 2 (Ala. Dept. of Revenue April 5, 2006) (RIA Checkpoint, Ala. Case Law) (failing to pay sales tax is willful if responsible person paid other creditors instead); *Campbell v. State*, No. P-04-359, 2005 Ala. Tax LEXIS 81, *4-5 (Ala. Dep't. of Revenue Nov. 10, 2005) (concluding that a person is responsible for unpaid withholding taxes even if other individuals are also responsible); *State v. King*, No. CV 91-B-2121-S, 1995 WL 423171, *3, *8 (N.D. Ala. 1995) (comparing Alabama law with I.R.C. section 6672)

Alaska – ALASKA STAT. § 23.20.240 (2006) (explaining collection of delinquent contributions).; *Breck v. State*, 862 P.2d 854, 856 n.1 (Alaska 1993) (holding that interest is due for the period of delinquency)

California – CAL. REV. & TAX. CODE § 6829 (West 1998) (sales tax); CAL. UNEMP. INS. CODE § 1735 (West 1986) (withholding tax); *State v. Wirick*, 112 Cal. Rptr. 2d 919, 924 (Cal. Ct. App. 2001) (arguing that an officer charged with causing the corporation to pay sales tax is liable)

Connecticut – CONN. GEN. STAT. ANN. § 12-414a (West 2000) (sales); CONN. GEN. STAT. ANN. § 12-736 (West 2000) (withholding). The sales tax statute is clear that interest applies back to corporate due date on responsible officer. The withholding tax statute mirrors 6672 and is unclear

Georgia – GA. CODE ANN. § 48-2-52 (Supp. 2007) (withholding).; GA. CODE ANN. § 34-8-167 (2004) (delinquent contributions); E-mail from Warren R. Calvert, Senior Assistant Attorney General, Georgia Department of Law, to T. Keith Fogg, Visiting Associate Professor of Law, Villanova University School of Law (Mar. 18, 2008, 18:13:54 EST) (on file with author)

Hawaii – HAW. REV. STAT. § 235-64(b) (Supp. 2007) (explaining employer liability for withholding taxes held in trust)

Idaho – IDAHO CODE ANN. § 63-3078 (2007) (withholding); IDAHO CODE ANN. § 63-3627 (2007) (sales); Idaho State Tax Commission Ruling, No. 19641, 2007 WL 2297072, *1 (Idaho Tax. Comm. April 3, 2007) (holding that the taxpayer is responsible for penalty and interest relating to failure to pay tax); Idaho State Tax Commission Ruling, No. 17949, 17950, 2004 WL 5215791, *1 (Idaho Id. St. Tax. Comm. Oct. 7, 2004) (holding that taxpayer is responsible for penalties and interest for failing to pay withholding and sales tax)

Illinois – 35 ILL. COMP. STAT. ANN. 735/3-7 (West 2006) (all trust fund taxes)

Indiana – IND. CODE. § 6-3-4-8(g) (West 2006) (withholding); IND. CODE § 6-2.5-2-1(b) (West 2006) (explaining tax on retail sales); IND. CODE ANN. § 6-2.5-9-3 (West 2006) (sales); *Russell v. Indiana Dep't. of State Revenue*, No. 49T10-0103-SC-31, 2001 Ind. Tax Lexis 68, *8-9 (Ind. T.C. Dec. 6, 2001) (holding that the statute dealing with liability does not allow a waiver of imposed interest)

Iowa – IOWA CODE ANN. § 422.16.4, 10 (West Supp. 2008) (explaining penalties for failure to withhold or pay tax); IOWA CODE ANN. § 422.4.19 (West 2006) (defining “withholding agent.”); IOWA CODE ANN. § 421.26 (West Supp. 2008) (explaining personal liability for tax due)

Kansas – KAN. STAT. ANN. § 79-3643 (Supp. 2007) (explaining personal liability for individuals responsible for collection of sales or compensating taxes); KAN. STAT. ANN. § 79-2971 (Supp. 2007) (explaining responsibility for collection of certain excise taxes); KAN. STAT. ANN. § 79-32,107(e) (Supp. 2007) (explaining penalties and interest for failing to collect, account for, and pay tax); KAN. STAT. ANN. § 79-32,100(b), (c) (Supp. 2007)

Kentucky – KY. REV. STAT. ANN. § 141.340(2) (LexisNexis Supp. 2007) (withholding); KY. REV. STAT. ANN. § 139.185 (LexisNexis 2007) (Sales); *Koppel v. Revenue Cabinet, Commonwealth of Kentucky*, 777 S.W.2d 938 (Ky. Ct. App. 1989); *Nienaber v. Revenue Cabinet, Commonwealth of Kentucky*, No. K92-R-71, 1996 Ky. Tax LEXIS 379 (Bd. Tax App. March 13, 1996)

Louisiana – LA. REV. STAT. ANN. § 47:1561.1 (2006) (withholding and sales)

Maine – ME. REV. STAT. ANN. Tit. 36, § 177.1 (Supp. 2007) (withholding and sales); *Prescott v. State Assessor*, 721 A.2d 169 (Me. 1998)

Maryland – MD. CODE ANN., [Tax-General] § 10-906(d) (LexisNexis 2004) (withholding); MD. CODE ANN., § 11-601(d) (LexisNexis 2004) (sales); *Nissenbaum v. Comptroller of the Treasury*, No. 3374, 1991 WL 322992 (Md. Tax 1991); *Fox v. Comptroller of Treasury*, 728 A.2d 776 (Md. Ct. Spec. App. 1999), *cert. denied*, 735 A.2d 1106 (Md. 1999) (sales)

Massachusetts – MASS. GEN. LAWS ANN. ch. 62B, § 5 (West Supp. 2008) (withholding); MASS. GEN. LAWS ANN. ch. 62C, § 31A (West Supp. 2008); MASS. GEN. LAWS ANN. ch. 64H, § 16 (West Supp. 2008) (Sales); *Berenson v. Comm'r*, 604 N.E.2d 704 (Mass. 1992) (sales); *Hazard v. Comm'r of Revenue*, No. C261103, 2006 WL 724543 (Mass. App. Tax. Bd. 2006) (withholding)

Michigan – MICH. COMP. LAWS ANN. § 205.27a(5) (West 2007); MICH. COMP. LAWS ANN. § 205.65 (West 2007) (sales and withholding); *Jamian v. Department of Treasury*, No. 256522, 2005 Mich. App. LEXIS 2601 (Mich. Ct. App. Oct. 10, 2005); *Dickow v. Department of Treasury*, No. 0329530, 2007 Mich. Tax LEXIS 38 (Mich. Tax Tribunal Nov. 27, 2007)

Minnesota – MINN. STAT. ANN. § 270C.56 (West 2007); MINN. STAT. ANN. § 290.92 subdiv. 1(4) (West 2007) (withholding); MINN. STAT. ANN. § 297A.61, subdiv. 2 (West 2007) (sales)

Mississippi – MISS. CODE ANN. § 27-7-307 (West 2006) (withholding)

Missouri - (The failure to file the sales or withholding tax return is a prerequisite to trigger the imposition of tax against the responsible officer; however, if triggered, interest is charged back to the due date of the entity's return); MO. ANN. STAT. § 143.241.2 (West 2006) (withholding); MO. ANN. STAT. § 144.157.1 (West 2006) (Sales); *Jones v. Director of Revenue*, 981 S.W.2d 571 (Mo.1998); *see also* *Garland v. Director of Revenue*, 961 S.W. 2d 824 (Mo. 1998)

Montana – MONT. CODE ANN. § 15-68-811 (2007) (sales); MONT. CODE ANN. § 15-30-203 (2007)

Nebraska – NEB. REV. STAT. § 77-1783.01 (2003); Neb. Dep't. of Revenue, 4-787-1989 Rev. 10-2007, Statutory Responsibilities for Collecting, Reporting, and Remitting Nebraska Taxes (2007)

Nevada – NEV. REV. STAT. ANN. § 360.297 (LexisNexis 2007) (Sales)

New Hampshire – N.H. REV. STAT. ANN. § 78-A:7 (LexisNexis Supp. 2006); N.H. REV. STAT. ANN. § 78-A:20 (LexisNexis 2001)

New Jersey – N.J. STAT. ANN. § 54A:9-6(f), (g), (l) (West Supp. 2008) (withholding); N.J. STAT. ANN. § 54:32B-14 (West Supp. 2008); N.J. STAT. ANN. § 54-32B-2(w) (West Supp. 2008) (sales); *Skaperdas v. Director, Division of Taxation*, 14 N.J. Tax 103 (1994), *aff'd*, 685 A.2d 18 (N.J. Super. Ct. App. Div. 1996) (sales). It is possible that New Jersey follows New York and is split on income taxes where interest does not accrue.

New Mexico – N.M. STAT. ANN. § 7-3-5 (LexisNexis 2004) (withholding); *In re Baker*, No. 2001-30, 2001 WL 35723190 (N.M. Tax. Rev. Dept. Nov. 1, 2001)

New York - N.Y. [Tax] LAW § 1133 (McKinney 2008) (sales); *Lorenz v. Dep't of Taxation*, 623 N.Y.S.2d 455 (N.Y. App. Div. 1995) (sales); N.Y. [Tax] LAW § 685(g) (McKinney Supp. 2008); *Yellin v. N.Y. Tax Commission*, 81 A.D.2d 196 (N.Y. App. Div. 1981). As mentioned

above, New York imposes interest back to the due date of the entity return for unpaid sales taxes but not for unpaid withholding taxes.

North Carolina – N.C. GEN. STAT. ANN. § 105-253 (West 2007) (withholding and sales); *In re Jonas*, 318 S.E.2d 869 (N.C. App. 1984); *In re Proposed Assessments*, No. 2000-70, 2000 N.C. Tax LEXIS 23 (N.C. Dept. Rev. Oct. 10, 2000); *In re Proposed Assessments*, No. 2004-45, 2004 N.C. Tax LEXIS 28 (N.C. Dept. Rev. June 25, 2004); N.C. Dep't of Revenue, Individual Income Tax Gift Tax Estate Tax Rules and Bulletins Taxable Years 2007 and 2008 (2008)

North Dakota – N.D. CENT. CODE § 57-38-60.1 (2000) (withholding); N.D. CENT. CODE 57-39.2-18.1 (2000) (sales)

Ohio – OHIO REV. CODE ANN. § 5747.07 (LexisNexis 2005) (withholding); OHIO REV. CODE ANN. § 5739.33 (LexisNexis 2005) (sales); *Soltesiz v. Tracy*, Tax Comm'r, 663 N.E.2d 1273 (Ohio 1996)

Oklahoma – OKLA. STAT. ANN. tit. 68, § 2385.3(E) (West Supp. 2008) (withholding); OKLA. STAT. ANN. tit. 68, § 2385.6(A) (West Supp. 2008); OKLA. STAT. ANN. tit. 68, § 1361(A) (West 2008) (sales); Oklahoma Tax Commission Decision, 2005-08-16-15, 2005 Okla. Tax LEXIS 15 (Okla. Tax Comm. Aug. 16, 2005)

Oregon – OR. REV. STAT. § 316.207(3) (2007) (withholding); *see also* OR. REV. STAT. § 316.162(3)(b) (2007); (no sales tax in Oregon)

Pennsylvania – 72 PA. STAT. ANN. § 7320 (West 2000) (withholding); 72 PA. STAT. ANN. § 7201(e) (West Supp. 2008) (sales); *In re Hartman*, 375 B.R. 740 (W.D. Pa. 2007)

Rhode Island – R.I. GEN. LAWS § 44-30-76, 85 (2005) (withholding); *In re Payroll Tax*, No. 98-14, 1998 R.I. Tax LEXIS 12 (R.I. Div. of Tax. Aug. 20, 1998); *In re Payroll Tax*, No. 93-22, 1993 R.I. Tax LEXIS 24 (R.I. Div. of Tax. July 14, 1993); *In re Withholding Tax*, No. 94-18, 1994 R.I. Tax LEXIS 17 (R.I. Div. of Tax. June 2, 1994); R.I. GEN. LAWS § 44-19-35 (2005)

South Carolina – S.C. CODE ANN. § 12-8-2010 (2000) (withholding); S.C. CODE ANN. § 12-54-195 (Supp. 2007) (sales)

South Dakota – S.D. CODIFIED LAWS § 10-45-55 (2004); S.D. CODIFIED LAWS § 10-59-1, 6 (2004, Supp. 2008)

Tennessee – TENN. CODE ANN. § 67-1-1443(a) (2006) (sales) (No state income tax)

Texas – TEX. [Tax] CODE ANN. § 111.016 (Vernon 2008) (sales); *Dixon v. State*, 808 S.W.2d 721 (Tex. App. 1991); (no state income tax)

Vermont – VT. STAT. ANN. tit. 32, § 5844 (2007) (withholding); VT. STAT. ANN. tit. 32, § 9703 (Supp. 2007) (sales); *Rock v. Dep't of Taxes*,

742 A.2d 1211 (Vt. 1999). *Rock* says withholding and sales tax provisions are treated the same even though they have slight variation. The withholding statute is silent on interest while the sales tax statute is explicit.

Virginia – VA. CODE ANN. § 58.1-1813 (2004) (withholding and sales); *In re Individual Income Tax*, No. 05-132, 2005 Va. Tax LEXIS 159 (Va. Dept. of Tax. Aug. 10, 2005)

Washington – WASH. REV. CODE ANN. § 82.32.145 (West 2000) (Sales); *In re Petition for Correction of Trust Fund Accountability*, No. 05-0066, 24 Wash. Tax. Dec. 454 (Wash. Dept. of Revenue Appeals Div. Mar. 30, 2005); (Washington has no income tax)

Washington, D.C. – D.C. CODE ANN. 47-4491 (withholding and sales); *Michael v. District of Columbia*, No. 5490-93 (D.C. Super. Ct. Tax Div. Dec. 30, 1997)

West Virginia – W. VA. CODE ANN. § 11-15-17 (LexisNexis 2005) (Sales); W.VA. CODE ANN. § 11-10-19 (LexisNexis 2003) (withholding); *Frymier-Halloran v. Paige*, 458 S.E.2d 780 (W.Va. 1995); *In re Bowen*, 116 B.R. 477 (S.D. W. Va. 1990); *In re Audia*, Nos. 93-384 CS, 93-385 WS, 1994 W. Va. Tax LEXIS 81 (W. Va. Dept. Tax and Revenue May 27, July 7, 1994). West Virginia imposes interest back to the due date of the return for sales taxes but not for income taxes.

Wisconsin – WIS. STAT. ANN. § 71-83(1)(b) (West 2004) (withholding); WIS. STAT. ANN. § 77.60(9) (West 2004) (sales); *Omegbu v. Wisconsin Dept. of Rev.*, No. 97-W-342, 1999 Wisc. Tax LEXIS 46 (Tax App. Comm. Oct. 14, 1999)

Appendix B – International Law Treatment of Responsible Officers

The concept of using businesses to collect taxes for the government exists in other countries. A brief survey of English speaking countries suggests that even more support exists for the concept of charging interest back to the due date of the corporate return relating to the collected tax. While these countries all have systems that differ from the responsible officer system used in the United States, their systems also have much in common with the United States. The concept of holding individual corporate officers responsible for the failure to pay over taxes collected by a corporation for the government is one which the countries share even if their systems of affecting the liability differ.

Canada

Canada has a provision similar to that of the United States for withholding income taxes. Persons paying salary, wages or other remuneration must withhold taxes and remit them to the Receiver General

at the time prescribed by regulation.¹⁸⁸ The amounts withheld pursuant to this provision are held “in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.”¹⁸⁹ Corporate directors of the entity that fails to withhold or remit such taxes are jointly and severally liable to pay that amount *plus any interest and penalties relating to it*.¹⁹⁰ The Soper case discusses the objective and subjective tests applied with respect to any director to determine if the director meets the exception for liability.¹⁹¹

In addition to the liability for the unpaid withholding taxes, the director may be liable for a 10 percent or 20 percent penalty for a knowing failure to remit the withheld taxes or gross negligence in the failure to remit.¹⁹² The Canadian statute holding directors liable developed in the 1980s when Canada felt too many companies were failing to pay collected employment taxes.¹⁹³ The current Canadian law makes clear that the directors of a company that does not pay over withheld employment taxes are personally liable for not only the taxes but the penalties and interest as well that are due from the company.¹⁹⁴

England

England requires an employer to withhold its mandated social security contribution from wages. Corporate officers incur liability if the “failure [to pay] appears to the [Inland Revenue] to be attributable to fraud or neglect on the part of one or more individuals who, at the time of the fraud or neglect, were officers of the body corporate.”¹⁹⁵ Unless only one

188. Income Tax Act, R.S.C., § 153(1) (1985) (Can.).

189. Income Tax Act, R.S.C., § 227(4) (1985) (Can.).

190. Income Tax Act, R.S.C., § 227.1(1) (1985) (Can.) (“Where a corporation has failed to deduct or withhold an amount as required . . . , has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required . . . , the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.”). See *Soper v. The Queen*, [1997] 3 C.T.C. 242 (Can.) (discussion of legislative history of 227.1); and *Veilleux v. The Queen*, [2001] 3 C.T.C. 288 (Can.).

The Income Tax Act section 227.1(2) provides some limitations on this liability as does section 227.1(3), which states: “A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.” Income Tax Act, R.S.C. § 227.1(2), (3) (1985) (Can.). See *Barnett v. Minister of National Revenue*, [1985] 2 C.T.C. 2336 (Can.) (sole shareholder liable and unable to successfully interpose defense of delegation to comptroller.); *Fraser v. Minister of National Revenue*, [1987] 1 C.T.C. 2311 (Can.) (director who was vice-President liable and unable to successfully argue that another officer could more easily pay); *Beutler v. Minister of National Revenue*, [1988] 1 C.T.C. 2414 (Can.) (holding the Director and President liable despite efforts to satisfy arrearages).

191. *Soper v. The Queen*, [1997] 3 C.T.C. 242 (Can.).

192. Income Tax Act, R.S.C. § 227(9) (1985) (Can.).

193. *Soper*, 3 C.T.C. at 250 (Can.).

194. Income Tax Act, R.S.C. § 227.1(1) (1985) (Can.).

195. Social Security Administration Act, 1992, ch. 5, § 121C(1)(b) (Eng.).

corporate officer exists, England apportions the liability among the officers based on relative responsibility.¹⁹⁶ The amount of liability asserted against the officers(s) includes interest and penalty amounts due from the corporation.¹⁹⁷ Interest then runs on the amount of the liability Inland Revenue specifies as due from the individual.¹⁹⁸

Australia

Corporate directors face personal liability for failure of the corporation to withhold income taxes.¹⁹⁹ The directors also face personal liability for failure of the corporation to timely pay the withheld taxes over to the government.²⁰⁰ The liability for failure to collect and pay over can equal the full amount of the taxes not paid. Interest on the unpaid liability is subject to the discretion of the tribunal imposing the liability.²⁰¹

196. Social Security Administration Act, 1992, ch. 5, § 121C(3)(b) (Eng.). England also imposes personal liability for evasion of Value Added Tax (VAT) if dishonest conduct played a role in its non payment. *Id.* at §§ 60-61. This personal liability also has a relative responsibility component. *Id.* at § 61(2).

197. Social Security Administration Act, 1992, ch. 5, § 121C(2)(b)(i)&(9) (Eng.).

198. Social Security Administration Act, 1992, ch. 5, § 121C(2)(b)(ii) (Eng.).

199. Income Tax Assessment Act, 1936, § 222AOB (Austl.).

200. Income Tax Assessment Act, 1936, § 222AOC (Austl.).

201. District Court Act, 1973, § 83A (Austl.).